

PHILLIPS PETROLEUM COMPANY 1978 ANNUAL REPORT

AR27







THIRD QUARTER 1978

HIGHLIGHTS

Oil and gas production rises worldwide page 2

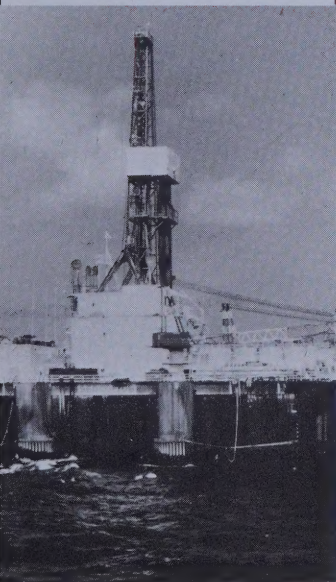
North Sea know-how leads the way ... page 5

Initial step toward a U.S. energy plan page 6

Financial data ... page 7

AR27

This drilling rig, Sedco 708, recently completed drilling a wildcat exploration well offshore Ireland. Oil was discovered in sufficient quantity to encourage further exploration. See story on page 2.



NEWSREPORT

To the Owners of Phillips Petroleum Company:

Phillips Petroleum Company's earnings increased in the first nine months of 1978, but were lower in the third quarter.

In the first nine months of 1978 Phillips estimated earnings were \$411.1 million, or \$2.67 a share, on revenues of \$5.22 billion. A year ago the company reported nine month earnings of \$369.8 million, or \$2.41 a share, on revenues of \$4.71 billion.

Income taxes for the period increased 36 percent to \$614.4 million after taking into account an investment tax credit of \$39.7 million. Income taxes equaled \$.60 for each dollar of pre-tax earnings.

In the third quarter, estimated earnings were \$107.8 million, or \$.70 a share, on revenues of \$1.75 billion, compared with 1977 third quarter earnings of \$123.2 million, or \$.80 a share, on revenues of \$1.55 billion.

The company's earnings in the third quarter were adversely affected by foreign currency translation losses caused by the decline in the value of the dollar in relation to other currencies. These losses totaled \$17.4 million. This compares with foreign currency translation gains of \$15.7 million in the same quarter of 1977. Excluding these losses and gains, earnings in the 1978 third quarter would have increased \$.11 a share.

In the first nine months of 1978, foreign currency translation losses were \$12.1 million, or \$.08 a share, compared with foreign currency translation gains of \$26.9 million, or \$.18 a share, reported for the same period a year ago.

Earnings in the nine month period represented a return on the company's average total assets of 9.1 percent compared with the 9.2 percent reported a year ago.

In both the third quarter and nine month period the company's earnings were helped by higher worldwide production of both crude oil and natural gas. (For details see page 2.)

On a geographical basis, U.S. operations accounted for 59 percent of the company's nine month earnings, or \$242.7 million. Foreign business accounted for 41 percent, or \$168.4 million.

Worldwide petroleum operations earnings were \$350.6 million for the nine month period, compared with \$311.6 million a year ago. U.S. petroleum earnings were \$224.3 million, compared with \$227.8 million a year ago. Foreign petroleum earnings were \$126.3 million, compared with \$83.8 million a year ago.

Worldwide chemical operations contributed \$52.1 million to nine month earnings, compared with \$53.2 million for the same period in 1977.

The company's other operations, which include equity in earnings of non-subsidiary companies and coal, uranium and geothermal activities, increased nine month earnings by \$8.4 million. For the same period in 1977 these operations increased earnings by \$5.0 million.

Wm. C. Brown

President and
Chief Operating Officer
November 10, 1978

M. Martin

Chairman and
Chief Executive Officer
Bartlesville, Oklahoma



THE WORLD OF PHILLIPS

WORLDWIDE SEARCH FOR ENERGY NOW PAYING OFF

A worldwide increase in exploration and production efforts in recent years is beginning to pay off for Phillips.

In the first nine months of 1978, the company's worldwide crude oil production jumped 23 percent and natural gas production was up 16 percent over the same period a year earlier.

Production gains resulted from higher output of both crude oil and natural gas in the Norwegian North Sea and higher crude oil output from Indonesia and the North Slope of Alaska.

Worldwide natural gas liquids output declined by 4 percent. Production of NGL will rise when the Teesside, England, processing plant begins operating, now scheduled in the second quarter of 1979. Completion of this plant has been delayed by numerous problems, including off-specification materials, unforeseeable design changes, unsatisfactory offsite welding, and generally lower than

expected productivity.

In the Norwegian North Sea, crude oil production averaged 354,300 barrels a day in the nine month period, 36 percent higher than a year ago. Phillips share of this production averaged 117,800 barrels a day. Phillips share of natural gas production, which began a year ago, averaged 299 million cubic feet per day.

In Indonesia, where crude oil production began in two areas last year, Phillips interest averaged 19,500 barrels a day for the nine month period.

In the U.S., the company's crude oil production during the first nine months of the year increased 9 percent. This increase is the result of new production from the North Slope of Alaska. Phillips share of this output averaged 18,800 barrels a day.

U.S. production of natural gas declined by 4 percent, slightly tempering gains made elsewhere in the world.

OFFSHORE IRELAND WELL ENCOURAGING IN TEST

Phillips recently completed a 14,500-foot wildcat exploratory well in 1,400 feet of water off the Atlantic coast of Ireland. Oil was discovered, but additional drilling will be necessary to determine the commercial potential of the field.

Plans are being made for further assessment of the discovery. A key

factor which must be considered is the water depth, which will increase production costs.

The exploratory well was drilled by Phillips Petroleum Company, Ireland, as operator for a four-company group.

Phillips has a 37.5 percent interest in the project.

PHILLIPS PEOPLE VISIT CHINA

A team of Phillips executives recently spent nearly two weeks in People's Republic of China for an opening round of discussions toward possible Phillips involvement in the development of the country's natural resources.

The Phillips group made numerous presentations to the

Chinese on the geophysics, geology and construction aspects of the petroleum industry. Nearly 200 Chinese officials participated.

Further visits with the Chinese are expected in the future. Representatives of several other U.S. companies are involved in similar discussions with China.

LIGNITE COAL RESERVES UPPED TO 8 BILLION TONS

Phillips Coal Company, a wholly owned subsidiary, has released a new estimate of its lignite coal reserves. The company's lignite holdings have been increased from more than four billion tons to in excess of eight billion tons. Ad-

ditional lease acquisitions and prospect re-evaluations brought about the new estimate. The company's reserves are located primarily in Louisiana, Arkansas, Texas, Mississippi, Alabama and Tennessee.

EXPLORATION WELL OFFSHORE GHANA STRIKES OIL AND GAS

Phillips Petroleum Company, as operator for a group of companies, has discovered oil and natural gas during exploration drilling off the coast of Ghana. The discovery well, the South Tano 1-X, is located 208 miles southwest of Accra, Ghana, and 20 miles offshore.

A test of the 12,000-foot well

flowed oil at a rate of 1,475 barrels daily and 8.2 million cubic feet of natural gas a day.

Future plans for the discovery are pending until results of the testing program are fully analyzed.

Phillips Petroleum Company holds a 50 percent interest in the group conducting this exploration.

IMPORTANT NEW FIELD FOUND OFFSHORE NIGERIA

Phillips is a participant in a group of companies whose petroleum exploration operations recently led to the discovery of an important new field offshore Nigeria. The discovery well, Beniboye North-1, encountered 13 hydrocarbon-bearing levels.

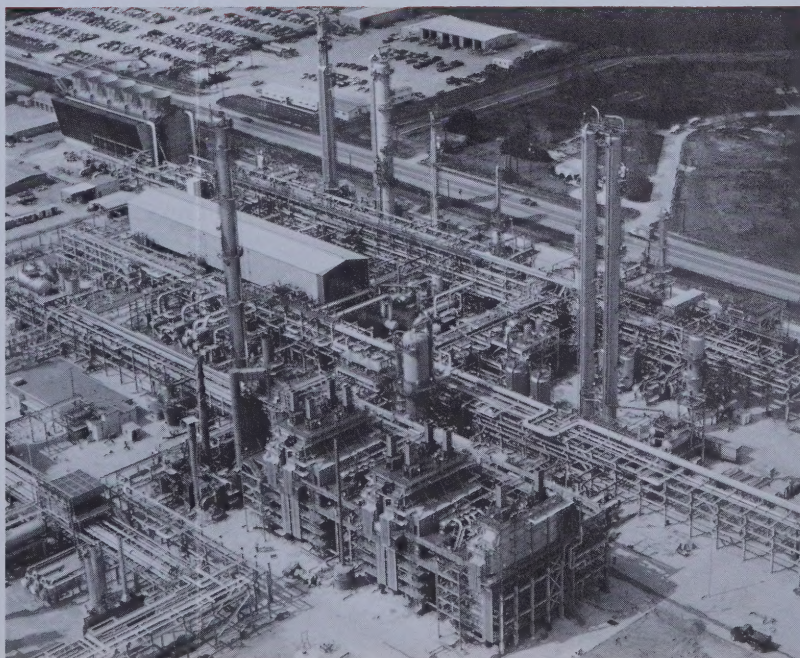
A second well is being drilled to further evaluate the structure and

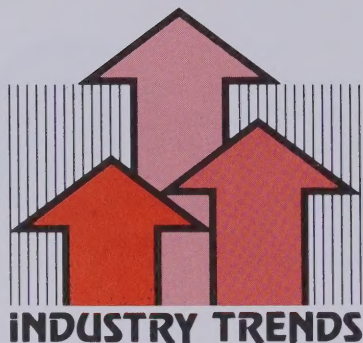
determine the field's extent. Phillips has a 22.5 percent interest.

Beniboye North-1 is located in a River Niger Delta license area, about two miles offshore Nigeria in waters less than 15 feet deep.

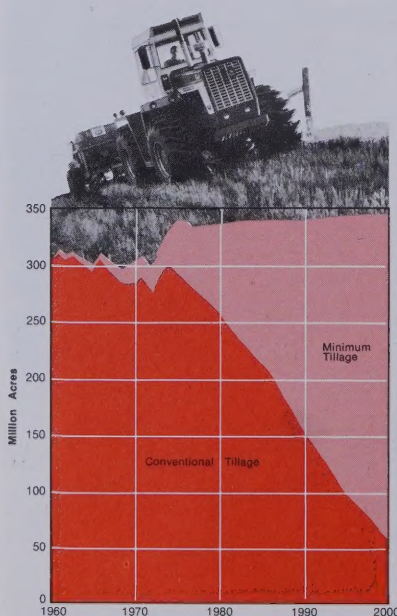
Phillips first Nigerian field began production in 1970 and 16 fields are currently netting the company 41,000 barrels of oil daily.

This new ethylene unit at the company's Sweeny refinery and petrochemical complex on the Texas Gulf Coast was completed in July and is now in operation. The one-billion-pound-per-year unit increases Phillips ethylene capacity to more than two billion pounds annually. Ethylene is a primary ingredient in producing the company's versatile line of Marlex plastics.





MINIMUM TILLAGE: THE COMING THING ON AMERICAN FARMS



A farm without a plow?

That's the direction things are heading on many American farms because the U. S., once topsoil rich, is rapidly losing its fertile soils. Overall, topsoil is being blown and washed away at a rate between four billion and six billion tons a year compared to only three billion tons a year in the Dust Bowl day of the 1930s.

Minimum tillage, the planting of fields without plowing, could provide a significant part of the solution to this problem.

Instead of plowing clean, weed-free furrows, farmers practicing minimum tillage (sometimes called conservation tillage) leave a blanket of stubble to guard against erosion. To plant, they use new machinery that slices through the stubble-topped earth, fertilizes, drops in seeds, then presses the slot closed. One machine does the whole job. Weeds are controlled by chemicals rather than machinery.

Phillips, through its agricultural fertilizer business, is helping to support several minimum tillage research projects.

So far, most minimum tillage machinery has been designed to plant corn and soybeans on the Great Plains. What farmers have been waiting for is someone to design an effective minimum tillage machine for one of the leading money crops — wheat.

A fertilizing minimum tillage wheat drill, designed by University of Idaho agriculture researchers, appears promising. Though still in the experimental stage, several farm equipment manufacturers have indicated an interest. Phillips has helped design the fertilizer attachment for this wheat drill.

Minimum tillage machinery must be heavy enough to plant through stubble, but still easy to pull behind a tractor. This machine is super heavy — more than four tons when fully loaded with seed and fertilizer — but it is easy to pull because knife-like steel shanks rip open the soil.

If this minimum tillage machine for wheat lives up to the expectations of the Idaho research team, it could be in wide use sometime in the 1980s. Minimum tillage is not a cure-all for the farmer's problem. For one thing, it demands careful use of herbicides to kill weeds and spare the crop.

An efficient, mass-produced minimum tillage machine for the wheat farmer could send a majority of the country's farm plows out to pasture. Agriculture experts estimate that some 36 million acres of land are now farmed by minimum tillage methods. By the year 2000 that figure could be close to 300 million acres, nearly 85 percent of America's farmland.

But, besides saving a lot of topsoil, minimum tillage offers other major benefits:

- Time needed to prepare fields for planting is reduced 20 to 80 percent. This will give farmers more time to plant additional acres and may allow more of them to raise two crops in the same season.
- Tractor fuel bills can be cut in half. Grain production normally requires five gallons of diesel fuel an acre. At today's cost of 55 cents a gallon, that means an annual savings of some \$27 million, assuming all the nation's 200 million acres in grain production were planted without a plow.
- Yields are dramatically increased. Stubble from previous harvests conserves moisture and keeps topsoil in place.

An example of increased yields comes from the University of Nebraska, where Phillips is supporting research in a minimum tillage crop rotation system called ecofallow. In a three-year cycle, ecofallow calls for planting two separate crops, then leaving the land unseeded for a season.

Farmers using this system are conserving about four inches of extra soil moisture a year and have sharply increased corn output in western Nebraska dryland areas.

PIONEERING TECHNOLOGY: THE KEY TO DELIVERING OFFSHORE ENERGY

If current exploration off the East Coast of the United States yields large deposits of natural gas, it is likely that technology pioneered by Phillips will help bring the energy to shore.

The company's special know-how in the field of gas production, processing and transportation stems from its experience in the Norwegian North Sea. There, Phillips and its partners built one of the world's most complex and expensive gas systems to link the Ekofisk area fields to consumers in continental Europe.

Two hundred feet below the surface of the North Sea, diver-welders work on a section of the natural gas pipeline that links the Ekofisk fields with a terminal in West Germany. The welding goes on inside a "habitat" fitted snugly around the pipeline, a technique pioneered by Phillips and diving companies.

The first challenge was to construct an offshore plant to separate the natural gas that is produced from the wells simultaneously with the oil. Later the plant was equipped to process the gas so it could be transported to shore. Such a plant normally would cover 70 acres of land. But the Ekofisk engineers had only a three-acre deck to work with. The result was one of the most efficient, compact gas treatment facilities ever built.

The second challenge was to build an offshore injection plant powerful enough to force huge volumes of gas back into the Ekofisk formation. This step was necessary to conserve natural gas until the pipeline to continental Europe was completed. The centrifugal compressors designed to do the job were one-third more powerful than any ever made. They are driven by turbines, much like jet engines, but fueled by natural gas.

Last came the most difficult challenge of all — laying the 274-mile natural gas pipeline from Ekofisk to Emden, Germany. While not a matter so much of providing new technology, applying current

pipeline technology under extreme North Sea conditions was difficult . . . and all work had to be accomplished in a manner acceptable to Norwegian, Danish and German authorities.

Seabed conditions created a major problem. Equipment used to blast trenches for the heavy pipe to settle in worked fine where the bottom was hard clay. But in soft, silty sand, the high-pressure water blasted trenches too wide for nature to cover. Phillips solution was to organize a giant diving operation to place sandbags — about 750,000 of them — over sections of the line where this problem existed.

As is true in most massive pipeline projects, some sections had to be repaired or replaced. Phillips contracted with diving companies that had developed hyperbaric welding for use on underwater pipelines. This involves placing a "habitat" around the pipe and evacuating the water so that diver-welders can work in a dry environment. This project marked the first use of hyperbaric welding on large diameter pipe in water more than 200 feet deep.



COMMENTARY

NEW ENERGY LAW: A FIRST STEP TOWARD NATIONAL PLAN

Shortly after Congress approved national energy legislation, W. F. Martin, chairman and chief executive officer, released this statement:

"Congress and the President have taken a step — though only a first step — toward what could become a national energy program."

He pointed out that while the new energy law falls short of many people's expectations, it is evidence to the rest of the world that Americans are beginning to take the energy problem seriously. "Eighteen months of debate probably helped clarify congressional as well as public understanding of the complex energy situation."

Martin said it is difficult to assess what impact the new legislation will have on Phillips. "For the immediate future, it appears that it will have little, if any, effect."

The Phillips chairman said the challenge to the petroleum industry now is to work with the government to insure that the regulations to implement the new legislation are both workable and practical.

In addition, Martin said, "A national energy policy must be regarded as an evolutionary program. It must be capable of being modified to correct flaws and molded to meet changing conditions. Only through this process

can the country develop an energy policy that makes a truly constructive contribution toward secure energy for Americans."

Positive aspects of the energy law noted by Martin include: strong incentives for homeowners to install energy-saving devices; incentives for the development and application of solar and other alternate fuels; and encouragement for the greater use of coal by industries and utilities.

"But the law deals with only certain facets of the energy problem," Martin warned. "It does not deal strongly with America's overdependence on foreign oil. It does not address the problems caused by the current pricing system that controls U. S.-produced crude oil below world prices. And it does not ease restrictions on the development of coal and uranium resources."

The Phillips chairman also called the new energy law over-complicated and said it provides for more government control over energy, not less.

"The pricing of natural gas cannot be considered a deregulation measure because even a partial relaxation of controls is postponed for many years, and the new law extends federal regulations to natural gas that is produced and sold within the same state."

OPERATING HIGHLIGHTS

	Three Months Ended September 30		Nine Months Ended September 30	
	1978	1977	1978	1977
(Thousands of Net Barrels Daily)				
Crude oil produced				
United States	127	118	125	115
Outside United States	188	135	188	139
Natural gas liquids produced	127	139	132	139
Total liquids produced	442	392	445	393
Crude oil refined	304	294	293	293
Petroleum products sold	486	490	504	520
Natural gas produced (net millions of cubic feet daily)	1,455	1,211	1,538	1,321

CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended September 30		Nine Months Ended September 30	
	1978	1977*	1978	1977*
Revenues:	(Thousands of Dollars)			
Sales and other operating revenues	\$1,726,751	\$1,516,757	\$5,137,305	\$4,625,528
Equity in earnings of nonsubsidiary companies	8,632	12,060	32,723	30,312
Other revenues	16,985	16,643	53,082	55,413
	<u>1,752,368</u>	<u>1,545,460</u>	<u>5,223,110</u>	<u>4,711,253</u>
Costs and expenses:				
Costs and operating expenses	1,190,000	1,088,898	3,507,947	3,267,298
Selling, general and administrative expenses	67,323	81,909	211,099	235,075
Depreciation, depletion, amortization and retirements	122,000	86,003	332,397	258,263
Taxes other than income taxes	30,646	26,675	87,947	78,380
Interest and expense on indebtedness	19,385	19,092	58,220	50,248
Provision for income taxes	215,218	119,656	614,364	452,152
	<u>1,644,572</u>	<u>1,422,233</u>	<u>4,811,974</u>	<u>4,341,416</u>
Net income	<u>\$ 107,796</u>	<u>\$ 123,227</u>	<u>\$ 411,136</u>	<u>\$ 369,837</u>
Net income per common share	\$.70	\$.80	\$ 2.67	\$ 2.41
Average shares outstanding (in thousands)	154,013	153,358	153,874	153,251

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

Funds provided from operations amounted to	\$ 241,256	\$ 220,073	\$ 811,552	\$ 682,437
While funds were expended for:				
Properties, plants and equipment	241,517	267,417	669,894	640,414
Investments	1,443	3,712	4,209	8,892
Dividends to Company stockholders	46,204	38,333	138,492	111,100
Reduction of long-term borrowings	25,956	11,761	96,811	95,280
Other	6,259	(15,842)	30,347	46,280
	<u>321,379</u>	<u>305,381</u>	<u>939,753</u>	<u>901,966</u>
Which left a deficiency of	<u>\$ 80,123</u>	<u>\$ 85,308</u>	<u>\$ 128,201</u>	<u>\$ 219,529</u>
This deficiency was financed by:				
Long-term borrowings	\$ 850	\$ 26,681	\$ 2,157	\$ 50,908
Property sales and retirements	11,028	11,146	40,262	48,602
Sales of investments	5,965	147	8,778	364
Proceeds from sale of Company stock	5,406	4,654	12,748	9,915
Change in long-term receivables	(3,175)	1,020	37,062	5,849
Other	788	—	1,076	—
Withdrawals from working capital	59,261	41,660	26,118	103,891
	<u>\$ 80,123</u>	<u>\$ 85,308</u>	<u>\$ 128,201</u>	<u>219,529</u>

CONDENSED CONSOLIDATED BALANCE SHEETS AT SEPTEMBER 30

	1978	1977*
Assets:	(Thousands of Dollars)	
Current assets	\$1,782,027	\$1,824,822
Investments and long-term receivables	482,501	480,954
Properties, plants and equipment	3,881,648	3,192,435
Prepaid and deferred charges	180,848	157,249
	<u>\$6,327,024</u>	<u>\$5,655,460</u>
Liabilities and stockholders' equity:		
Current liabilities	\$1,415,045	\$1,173,995
Long-term debt	702,806	856,245
Obligations under capital leases	129,493	153,726
Other liabilities and deferred credits	707,489	500,671
Stockholders' equity	<u>3,372,191</u>	<u>2,970,823</u>
	<u>\$6,327,024</u>	<u>\$5,655,460</u>

*Late in 1977 the Company changed its method of accounting for non-mineral leases in accordance with Financial Accounting Standards Board Statement No. 13 to retroactively apply the provision of the Statement to January 1, 1973 and accordingly, net income for 1973 was reduced \$18,170,000 (\$.12 per share). Interim financial statements for 1977 have been restated to reflect this accounting change; however, the change had no material effect on the 1977 third quarter or nine months earnings.

A SPECIAL MESSAGE: The Cost of the Dollar's Decline

With increasing severity the erosion of the dollar is adversely affecting the earnings of more and more U.S. multinational corporations. The weakened dollar was the primary cause of the decline in Phillips third quarter earnings. And it is possible that a continued decline of the dollar may penalize future earnings.

This special message is designed to address three questions of importance to stockholders.

- (1) How do changes in the value of the dollar affect the company's financial position?
- (2) How is the company attempting to limit the adverse effects of these changes?
- (3) What can be done to prevent further erosion of the dollar?

In reporting earnings to stockholders, all U.S. corporations must convert their foreign operating results, as well as related balance sheet items such as foreign income tax liabilities and short and long term debt, into U.S. dollars. This complicated accounting procedure usually results in a gain or loss, depending on the strength of the dollar in relation to the foreign currencies involved in the corporation's activities. It is important to keep in mind that translation losses and gains are not a reflection of a corporation's operating performance. Rather they result when key financial items represented by foreign currencies are translated into U.S. dollars.

A currency translation problem can crop up in many Phillips operating situations. For example, when the company sells Ekofisk crude oil for U.S. dollars it must pay Norwegian taxes on that sale. Normally these taxes aren't paid until several months after the sale. If during that time the dollar declines in value relative to the Norwegian krone, Phillips incurs a translation loss.

Throughout 1978 the dollar has dropped in value in relation to most foreign currencies. For instance, since the beginning of this year, the value of the dollar has declined 19 percent in relation to the German mark and 7 percent in relation to the Norwegian krone.

To reduce these losses, Phillips is putting increased emphasis on reducing the company's vulnerability to fluctuations in currency values. And as in the past,

Phillips will continue to seek advice from independent monetary experts.

It must be recognized, however, that the long-range solutions to strengthening the dollar lie outside the company's influence. The decline of the dollar is tied to the overall economic condition of the U.S. as seen by the rest of the world. Basically, the major factors behind the dollar's decline appear to be:

... Inflation. During the past year prices rose more in the U.S. than in many countries including Switzerland, West Germany or Japan, the three countries where the value of the dollar has declined most. Furthermore, there is widespread belief that inflation will persist in the U.S. because the Administration continues to spend more than the government collects in taxes, which increases the pressure to print more dollars. This destroys confidence in the dollar and reduces its value even more.

... Imported Energy. The U.S. now imports roughly 45 percent of the oil it needs. This oil now costs \$120 million a day and oil-exporting countries end up with more dollars than they want and transfer them into other currencies, which again weakens the dollar even more.

... Trade Deficit. While oil contributes to the U.S. trade deficit, the U.S. also imports a lot of manufactured goods. This year, Japan, from which the U.S. gets everything from motorcycles to television sets, will account for 40 percent of the U.S. \$33 billion trade deficit. Such a deficit breeds suspicion that the U.S. is becoming less competitive, less innovative and less able to stop its trade deficit from climbing even higher. If that's believed to be the case then the dollar again declines even more.

The Carter Administration is attempting to stabilize and strengthen the dollar through various programs, the most recent of which is a request to the American public to cooperate in a system of voluntary wage and price controls. It remains to be seen how successful this and other programs will be. Phillips will monitor them and will be ready to adjust its financial management policies accordingly.

PHILLIPS PETROLEUM COMPANY
BARTLESVILLE, OKLAHOMA 74004

FINANCIAL

	1978	1977
Total revenues	\$7,423,100,000	\$6,405,800,000
Net income	\$ 710,500,000*	\$ 516,900,000
Per average share outstanding \$	4.61*	\$ 3.37
Return on average total assets		
Excluding gain on sale of Pacific Petroleum Ltd. ...	8.8%	9.4%
Including gain on sale of Pacific Petroleum Ltd.	11.6%	9.4%
Dividends paid	\$ 184,800,000	\$ 149,500,000
Per share	\$ 1.20	\$.975
Average shares outstanding ...	153,987,000	153,350,000
Capital expenditures	\$ 974,900,000	\$1,127,700,000
Total assets at year-end	\$6,935,400,000	\$5,836,500,000

OPERATING — net barrels daily

Crude oil produced		
United States	125,000	117,000
Outside U. S.	185,000	148,000
Natural gas liquids produced ...	134,000	138,000
Total liquids produced	444,000	403,000
Crude oil refined	302,000	297,000
Petroleum products sold	516,000	532,000
Natural gas produced — net thousands of cubic feet daily.	1,549,000	1,343,000

*Includes an after tax gain of \$169,900,000 or \$1.10 per share on sale of Pacific Petroleum Ltd.

ABOUT THE COVER

The massive Ekofisk oil and gas production and processing complex glimmers in the North Sea dusk 180 miles off the coast of Norway. All major facilities were completed in 1978, nearly ten years after Phillips discovered the first of seven area fields. Ekofisk produced enough energy in 1978 to power a city the size of Chicago, and production will increase into the 1980s.

CONTENTS

2	To the Owners
5	Government Impact Statement
6	Natural Resources
16	Petroleum Products
20	Chemicals
24	Research
26	Corporate Citizenship
28	Phillips People
30	Financial Review
35	Financial Statements
43	Ten-Year Statistics
47	Products and Services
48	Directors
49	Officers, Managers



W. F. Martin, chairman and chief executive officer

Wm. C. Douce, president and chief operating officer

Increased energy production keynoted Phillips performance in 1978. On a worldwide basis, the Company's combined output of petroleum liquids and natural gas rose 12% over 1977 production.

The Company's financial results also were strong. Earnings were \$710.5 million, or \$4.61 a share on revenues of \$7.42 billion. This compares with earnings in 1977 of \$516.9 million, or \$3.37 a share on revenues of \$6.41 billion.

Two factors—the sale of a Canadian interest and currency translation effects—tended to obscure the Company's true operating performance for the year. The sale of our 48% stock interest in Pacific Petroleum Ltd. of Canada provided an after-tax gain of \$169.9 million, or \$1.10 a share. With this one-time gain excluded, the Company's earnings in 1978 were

14 cents a share higher than earnings reported by Phillips in 1977.

We would have preferred to report the gain from the Pacific sale as an extraordinary item, separate from operating earnings, but accounting requirements do not permit such a segregation. Likewise, accounting requirements mandate the inclusion of foreign currency translation fluctuations in our earnings results, even though these fluctuations are tied primarily to changes in the value of the dollar and do not reflect on the Company's operating performance. Currency translation losses reduced earnings by \$28 million in 1978, compared with a small gain in 1977.

Phillips return on assets in 1978, excluding the sale of Pacific stock, was 8.8%. This compares with a return of 9.4% recorded in 1977.

to the owners

Income taxes rose significantly in 1978, increasing 29% to \$866.4 million excluding the effects of the Pacific sale. Income taxes amounted to 62 cents on every dollar of pretax income.

Evaluating 1978

In this year's annual report, we report net income for each of the Company's three operating groups — Natural Resources, Petroleum Products and Chemicals.

Contributing to the strong 1978 performance of the Company's Natural Resources Group was a 17% increase in worldwide crude oil production, reflecting higher output both in the U. S. and overseas. The largest gain in crude oil production occurred in the Company's 37% owned Greater Ekofisk Development in the Norwegian North Sea. In the U. S., Phillips crude oil production increased for the second year in a row, reflecting higher production from Alaska.

The Company's worldwide sales of natural gas increased because 1978 was the first full year of natural gas sales from the Ekofisk area. Higher prices for natural gas also aided Company earnings in 1978, although they were offset to some degree by lower prices for overseas crude oil.

While the Company's search for new energy reserves was successful on several fronts, our expanding exploration effort resulted in a 32% increase in exploratory and dry hole expenses.

In the refining, marketing and transportation activities operated by our Petroleum Products Group, earnings fell markedly from the 1977 level. The principal adverse factor was lower prices for liquefied petroleum gas, the result of abundant industrywide supplies.

The Chemicals Group experienced higher revenues but lower earnings in 1978, primarily because raw material and operating costs increased at a higher rate than product prices. This cost-price squeeze has affected much of the petrochemical industry for several years.

Looking Ahead

Our performance in 1979 will reflect further increases in oil and natural gas production. The major contributor to increased energy output will be our Norwegian North Sea operations, where three additional oil fields are scheduled to go into operation in 1979. In addition, a significant increase in our worldwide output of natural gas liquids is expected this year with the anticipated completion of liquids processing and handling facilities at Teesside, England, Terminal. Both petroleum liquids and gas production from the Greater Ekofisk area fields are expected to continue rising through the early 1980s.

In our refining, marketing and transportation operations, we continue to emphasize improved efficiencies. Our U. S. marketing operations have been trimmed significantly in recent years, and major improvements are under way in our crude oil transportation system that will reduce costs and increase flexibility in supplying feedstock to our major refineries. When completed next year, the modernization and expansion of

the Sweeny, Texas, refinery will allow us to process less expensive grades of crude oil while producing greater quantities of high-value products.

Increased ethylene and plastic resin capacity at our petrochemical complex near Houston, Texas, should yield higher revenues for our chemical business in 1979. We will continue to meet the problem of rising costs by increasing the feedstock and fuel economy of our operations while minimizing our less profitable product lines and building on the strongest.

Our capital expenditures in 1979 will be greater than the 1978 figure of \$975 million. The largest share of our capital spending this year will be toward finding, developing and processing petroleum. About 65% of our 1979 capital expenditures will be directed toward domestic projects.

Summarizing Phillips major thrusts in the years ahead, our focus will be on increasing production of oil and natural gas, combined with a broadening of our resource base into lignite coal and uranium. We will continue to stress greater efficiencies in our petroleum product operations while following a course of selective chemical expansion.

Our success in meeting these objectives depends in part on factors beyond the Company's immediate control. Indeed, there are numerous unanswered questions as we look ahead.

The Unanswered Questions

The major question confronting oil companies as well as consumers is what will happen to the supply and price of energy in the coming months. The disruption of oil exports from Iran has resulted in a world crude oil shortage, with demand exceeding supply by nearly 5%. While Iranian production could possibly be restored in the near future, much depends on political development within Iran. Furthermore, there is serious question whether production will ever rise to its prior level.

In the meantime, the tightening of crude oil supplies has raised concerns about escalating prices. Already, the Organization of Petroleum Exporting Countries (OPEC) has chosen to move up its schedule of price increases that were not planned to take effect until later this year. Moreover, oil not under long-term contracts is selling for prices well above the price charged by OPEC members.

Obviously, the supply and price problems are world concerns, and each nation will be dealing with them in its own way. In the United States, refinery runs are being reduced and larger refiners are being asked by the government to share crude oil supplies with smaller refiners. If the supply situation worsens, there is the possibility of increased federal intervention in the form of an across-the-board allocation of crude oil supplies to all refiners.

Inflation is another factor of great concern. Phillips supports the current anti-inflation program; however, inflation will only be effectively curbed when government restrains spending and limits growth in the money supply. Unchecked inflation will further undermine the

value of the dollar, and thereby provide justification to OPEC countries for more oil price increases.

Still another uncertainty is what actions will be taken—or not taken—by the federal government in the coming months to provide better direction to the nation's energy policies. Currently, the country's energy policies are a crazy quilt of legislation and regulation. Ironically, despite the complex and often contradictory nature of the country's energy policies, there is virtually unanimous agreement that major efforts must be directed toward encouraging energy conservation and increasing domestic energy production in order to reduce oil imports and protect national security.

Several steps could be taken *immediately* toward reaching the goal of rebuilding the nation's energy security.

- *Postponement of lead phase down.* Current regulation requires that lead content in regular and premium grades of gasoline be phased down this fall. This move is being mandated even though the amount of lead used in gasoline is being reduced markedly each year since virtually all cars produced since 1975 require unleaded fuel. To manufacture regular and premium gasolines with reduced amounts of lead will require the addition of octane-boosting blending materials. However, postponement of the lead phase down would make those blending materials available for use in unleaded gasoline, thereby reducing the likelihood of shortage of this much-needed fuel.

- *Reasonable interpretation of natural gas law.* The natural gas pricing bill passed last fall provided some encouragement to natural gas exploration and development activity. However, even the limited incentives of the bill are threatened by the lack of reasonable and practical implementation policies. Current policies proposed by the Federal Energy Regulatory Commission should be modified to reflect the intent of the original legislation, which was to encourage a vigorous gas exploration effort.

- *Removal of petroleum price controls.* For several years, the government has controlled the price of domestically produced crude oil and many products, including gasoline. Though politically popular, this policy has been self-defeating. By attempting to protect American consumers from higher energy costs, it has discouraged conservation and domestic energy development and thereby increased the country's dependence on less secure, higher cost imported energy. A gradual removal of these controls would not only stimulate oil and gas programs, including much needed refinery expansions, but also speed the development of new energy sources which in many cases cannot presently compete with price-controlled petroleum.

- *Encouragement to conservation.* Energy-saving techniques are well-known, but the incentive to apply them is often lacking. The greatest strides in energy savings have been within industry, where conservation

measures have helped reduce operating costs. Individual consumers, on the other hand, have been more shielded from rising fuel costs and as long as federal price controls perpetuate this situation, the incentive to save will be dampened.

Two Options for Action

Basically, the nation has two options as it comes to grips with the energy situation. One option, typified by many federal actions up to this point, requires that energy producers and consumers continue to relinquish their decision-making prerogatives to federal bureaucracies. As recent history has shown, this approach curtails personal freedom of choice, causes supplies of conventional fuels to dwindle and slows the development of new technologies and new energy sources. In short, efforts to manage the energy problem through bureaucratic means will virtually assure inadequate supplies in the future, and perhaps much sooner than any of us realize.

The alternative course of action—one that merits support—is for government to set broad and consistent energy objectives, then allow the marketplace of private enterprise and American strength in technology to seek out energy solutions. This route calls into action the nation's most precious resource—its innovative people—while at the same time protecting our basic institutions and personal liberties.

There appears to be a growing recognition, even among leaders in government, that a dynamic, competitive marketplace can play a vital role in solving our country's problems. This change in attitude is exemplified by the deregulation of the nation's airlines and moves to lessen controls in other industries. In addition, recent statements by Department of Energy officials have pointed out that regulations have led to shortages, delays and the misallocation of resources.

The public, too, has expressed its faith in the problem-solving ability of the marketplace and private enterprise. A recent survey indicated that 65% of the American public would support the gradual removal of price controls from domestic oil production in order to encourage development of more crude oil production in the U. S.

The stage is set for a move away from government rule-making and toward consumer and business choice-making. But such a move will not occur without a strong push by individual citizens. We urge you to make your views known to your elected representatives. The developments of 1978 and early 1979 underscore the need for forthright action to increase America's energy security.

For the Board of Directors,



President and
Chief Operating Officer
March 20, 1979



Chairman and
Chief Executive Officer

The high cost of federal government regulation is now recognized as a significant contributor to inflation. Based on a study prepared for the Congressional Joint Economic Committee, the total cost of federal regulations for fiscal year 1978 was estimated at approximately \$100 billion, or about five dollars a day for every American family.

The pervasive influence of government regulations, however, cannot be measured in terms of dollars and cents alone. There is growing evidence that government regulations are destroying the risk-and-reward system that drives our private enterprise economy.

America has grown strong by nurturing innovation and experimentation in the utilization of its resources and people. Private enterprise has taken the risks and invested the capital to create ever-expanding job opportunities and an unsurpassed wealth of products and services for consumers. But today the venturesome spirit of American industry is being undermined by the limitations, the delays and the uncertainties posed by government regulations. Here are a few examples relating to the petroleum industry:

THE SEARCH Consider all land east of the Mississippi River. That is approximately the amount of U. S. land surface that is now effectively off limits to the search for and the development of energy resources. Much of this land, such as Alaska, is considered to have high potential for petroleum development. The removal of such lands by the government not only prohibits oil companies from searching in promising areas, but it runs counter to a national effort to increase energy independence.

Even on land that is open to exploration, the incentive to search is dampened by regulatory delays that add uncertainties and drive up costs. For example, it can take 18 months or longer from the time the government invites industry to bid on potential drilling sites to the time the bids are actually taken. Even after a bid has been accepted, there is no guarantee that exploration can begin. Court action on the interpretation of various regulations blocked drilling in the Baltimore Canyon off the East Coast for about a year and a half.

One of the most persistent deterrents to the search for new petroleum reserves in the United States is price controls, which affect 70% of crude oil and virtually all natural gas production. These controls set prices for domestically produced oil and gas well below world market levels. As the search for energy takes oil companies into frontier areas where operating conditions are difficult, such as Alaska and offshore, the costs of replacing oil and gas consumed by the nation become increasingly expensive. Meanwhile price controls jeopardize the chances of recovering money invested to find new reserves of oil.

REFINING An outgrowth of crude oil price controls is the government's complicated entitlements program, which affects refining operations. Under this program, the government forces refiners who process greater amounts of old domestic oil (oil that is under government price controls) to make payments to refiners who process high-cost imported oil and decontrolled U. S. oil. The combined effect of the price control and entitlement programs is to subsidize the importation of foreign oil, while penalizing companies, such as Phillips, who in the past have made heavy investments in developing domestic reserves that now must be sold at controlled prices. In 1978 Phillips had to pay other refiners a net of \$36.4 million so that Phillips could process oil from older producing fields.

Protection of the environment has long been a major priority of the Company, but confusing and time-consuming environmental regulations are acting as a deterrent to much needed U. S. refinery expansion. In many instances, it is not the regulatory standard itself that is the problem, but the way regulations are interpreted by different regulatory agencies. For example, it took more than a year to obtain environmental permits for the enlargement of the Sweeny, Texas, refinery, as various regulatory agencies debated the interpretation of several regulations.

MARKETING A complex series of government regulations influence not only the price an oil company can charge for its products, but where it can market them. For the past five years, Phillips has been attempting to increase the efficiency and profitability of its marketing operations by withdrawing from uneconomic locations. Yet our efforts have been frustrated by product allocation regulations that require us to continue to supply products to certain areas of the United States. Such regulations not only affect Company earnings, but inhibits flexibility to adjust operations to meet the needs of Phillips customers.

HUMAN EFFECTS In a large and complex society such as ours, some degree of government regulation is obviously necessary. Yet regulation becomes excessive when it undermines the incentive to create, to innovate, to take advantage of opportunities, to invest in the future. Regulation becomes excessive when it stifles job creation, diverts massive amounts of capital from productive to non-productive uses and lowers the nation's living standards by driving consumer costs higher and higher.

Our private enterprise economy nurtures progress by encouraging people to *explore* the unknown. Excessive regulation, on the other hand, directs human effort toward *avoiding* the unknown.

government impact statement

NET INCOME	1978	1977
	(millions of dollars)	
Petroleum exploration and production	\$415	\$351
Coal, uranium, geothermal	(21)	(16)
Equity in earnings of nonsubsidiary companies	(10)	2
	<u>\$384</u>	<u>\$337</u>

The Natural Resources Group carried out an expanded program of finding and producing energy in 1978. The combined worldwide production of crude oil and natural gas liquids rose 10%. Phillips increased its estimate of lignite coal reserves to eight billion tons, double the previous estimate, and signed its first contracts to sell coal and uranium.

Sales and other operating revenues and earnings increased in 1978 because of higher crude oil and natural gas production as well as higher natural gas prices in the U. S. In the U. S., crude oil production rose 7% as output from the North Slope of Alaska continued to increase. Overseas, Phillips oil production rose 25%. The largest gain was made in the Norwegian North Sea, followed by increases in Indonesia and Nigeria.

Worldwide natural gas output rose 15%, with production from the Norwegian North Sea accounting for the higher output. Natural gas production in the U. S. declined, reflecting the general industry trend.

PETROLEUM LIQUIDS PRODUCED	Net Barrels Daily	
	1978	1977
UNITED STATES		
Crude oil	125,000	117,000
Natural gas liquids	133,800	138,200
Total U. S.	258,800	255,200
OUTSIDE UNITED STATES		
Crude oil	185,400	147,900
Natural gas liquids	200	200
Total outside U. S.	185,600	148,100
WORLDWIDE		
Crude oil	310,400	264,900
Natural gas liquids	134,000	138,400
Total worldwide	444,400	403,300

Phillips drilled or participated in 63 oil and gas exploratory wells in 1978, of which 20 were dis-

coveries. Capital and exploration expenditures to acquire, find and develop oil and gas declined 25% to \$612 million.

The Company also participated in 156 other exploratory wells in the U.S. through farmout arrangements. Under these arrangements other firms drill on Company acreage in return for an interest in the acreage and any production that is found. In turn, the drilling is completed without Phillips having to bear the cost.

DRILLING STATISTICS*	Exploratory		Development	
	1978	1977	1978	1977
UNITED STATES				
Gross wells	10	19	505	506
Net wells:				
Oil	—	—	36	74
Gas and gas condensate	2	1	41	45
Dry holes	4	4	17	15
Total	6	5	94	134
OUTSIDE UNITED STATES				
Gross wells	53	37	11	18
Net wells:				
Canada	1	—	—	—
Latin America	2	1	—	—
Europe	4	2	2	4
Africa	4	3	1	1
Southeast Asia	9	7	—	1
New Zealand and Australia	—	1	—	—
Total	20	14	3	6
Oil	4	5	3	4
Gas and gas condensate	1	—	—	1
Dry holes	15	9	—	1

*Excludes farmout arrangements.

Reserves

Reserves of liquids and natural gas fell as production exceeded additions from exploration and development programs. In addition, revised estimates reduced crude oil reserves in the Salawati Island area of Indonesia. Estimated worldwide proved reserves of liquids (crude oil, condensate and natural gas liquids) decreased 9%. Natural gas reserves declined 5%.

Phillips estimates reserves on the basis of current reservoir information, technology and economics. Although producibility of these reserves

natural resources



In the Lower Cook Inlet off Alaska's southern coast, Phillips began drilling in 1978 on high-potential acreage acquired through leases costing nearly \$200 million. Phillips 1978 exploration in Alaska also included participation in two North Slope wells, both non-commercial discoveries.

is reasonably certain, reserves cannot be measured precisely. Estimates of proved reserves are:

PROVED RESERVES — WORLDWIDE

	Petroleum Liquids (million barrels)	Natural Gas* (billion cubic feet)
Beginning 1978	1,659	10,252
Revisions of previous estimates	(65)	38
Improved recovery	23	—
Purchases of minerals in place	1	3
Extensions, discoveries and other additions	18	129
Production	127	631
Sales of minerals in place	—	4
Total year-end 1978	1,509	9,787
U. S.	522	4,333
Outside U. S.	987	5,454
Percent developed at year-end ..	68%	78%

*Includes reserves applicable to royalty interests unless gas is taken in kind.

Included above is the Company's share of reserves as provided by terms of production-sharing

contracts with the governments of other countries, which totaled eight million barrels of liquids and 19 billion cubic feet of natural gas.

In the U. S. the Company has access to additional reserves through contracts and other arrangements. Year-end estimates of reserves were:

ADDITIONAL AVAILABLE RESERVES — U. S.	1978	1977
Liquids (millions of barrels)	350	265
Natural gas (billions of cubic feet)	2,102	2,000

Prices

Phillips sold petroleum liquids and natural gas for higher average prices in 1978. In the U. S. approximately 84% of our crude oil production was under federal price controls. Of this production, 32% was classified as upper tier and 52% lower tier under federal pricing categories. The remaining 16% not under price controls came from stripper leases, which produce an average of less than 10 barrels per well a day.

AVERAGE PRICES —

Petroleum Liquids and Natural Gas	1978	1977
Crude oil (per barrel)		
U. S.	\$ 8.53	\$ 8.41
Norway (landed Teesside)	13.94	14.16
Nigeria (export sales)	14.11	14.58
Natural gas liquids — U. S. (per barrel)	6.93	6.01
Natural gas — U. S.*		
(per thousand cubic feet)	.88	.71
(converted to barrels of oil on energy equivalent basis)	5.13	4.16

*Excludes sales of liquefied natural gas from Kenai, Alaska.

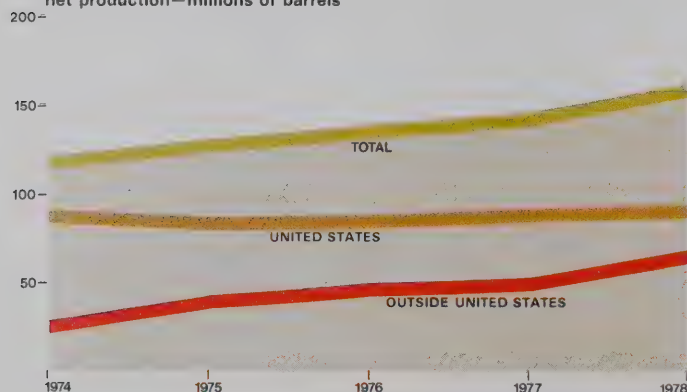
U. S. natural gas revenues rose 18% largely because of government-allowed price increases for recently discovered gas and for gas sold under renewed contracts.

For intrastate gas (gas produced and sold in the same state), prices were generally higher, resulting in higher revenues. In 1978 intrastate markets accounted for 28% of the Company's natural gas sales volume, compared with 26% in 1977. Phillips also realized higher prices for liquefied natural gas delivered under long-term contracts from our 70% interest Kenai, Alaska, liquefaction plant to two Japanese utilities.

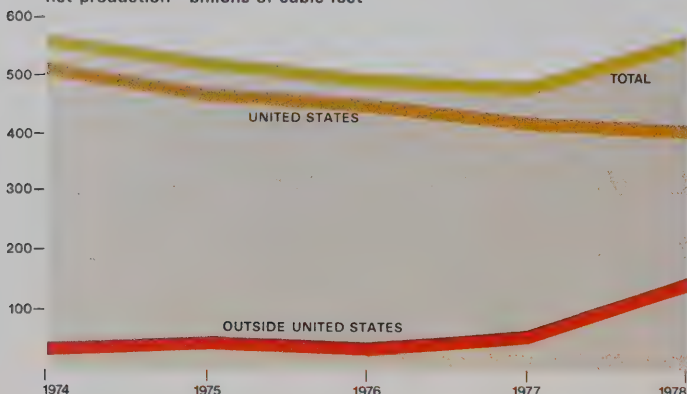
North America

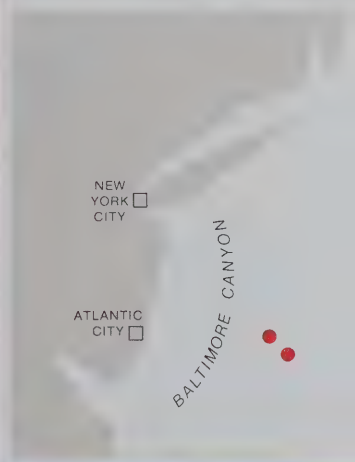
Phillips U. S. crude oil production increased 7%, largely because 1978 was the first full year

CRUDE OIL AND NATURAL GAS LIQUIDS
net production—millions of barrels



NATURAL GAS
net production—billions of cubic feet





On a rig 90 miles off the coast of Atlantic City, New Jersey, roughnecks strain to “make a connection” — screw a new joint of drillpipe into the top of a two-mile long string already in the hole. Phillips spent more than \$10 million to participate in two unsuccessful wells in the Baltimore Canyon.

of production from the North Slope of Alaska Phillips share of North Slope production averaged 19,500 barrels daily. Production of oil in the lower 48 states declined 6%.

In 1978, 31% of the Company's U. S. oil production came from some 413 secondary recovery projects. Secondary recovery boosts production mainly by injection of water or gases into underground formations. A major secondary recovery project undertaken during the year was the unitization of a 7,000-acre, 150-well waterflood project in New Mexico. Phillips owns approximately 30% interest in the project. Unitization agreements enable a producing reservoir owned by several owners to be operated as a single unit, thus avoiding unnecessary drilling and other economic waste. The program is expected to boost production approximately 200% by 1980.

Natural gas liquids production declined 3%. In an effort to stem the downturn in natural gas liquids production, Phillips continued its program to extract more liquids from natural gas processed in Phillips plants. Five extraction facilities were expanded and a new one was put into operation during the year, mainly to supply ethane for the Company's new one billion pounds a year ethylene plant at Sweeny, Texas. Two more extraction facilities are under construction in Texas.

Phillips U. S. natural gas production declined 3% in 1978 compared to the 7% decline in 1977. About 79% of Phillips gas production and 86% of its oil output came from onshore fields.

Exploratory drilling efforts in 1978 were concentrated in Alaska and the Canadian Arctic. On the North Slope of Alaska east of Prudhoe Bay, the Company participated in two wells. Initial tests indicate both are non-commercial discoveries. In 1979 Phillips will participate in two more wells in the same general area.

In Alaska's Lower Cook Inlet, the Company participated in a non-commercial discovery and began drilling another well on 34,000 net acres acquired in the 1977 federal lease sale. Exploration of the area is expected to take several years.

In the Canadian Arctic Islands, Phillips participated in two wells, including a 20% interest discovery that flowed approximately 20 million cubic feet of gas a day. Phillips is evaluating test results and determining the limits of the reservoir. The Company plans to participate in two more Arctic Island wells in 1979.

In the lower 48 states, Phillips participated in two unsuccessful wells in the Baltimore Canyon off the coast of New Jersey. In a Gulf Coast lease sale, Phillips won the right to drill on two blocks offshore Louisiana and plans to begin drilling there in 1979.

Norway

Oil production from the Ekofisk area fields averaged 357,000 barrels a day — a 27% increase over 1977. Phillips 37% share of this production averaged 116,800 barrels a day. In June, production started in the Tor Field, the fourth of the seven Ekofisk area fields. Production is expected to increase in 1979 when the last three fields, Albuskjell, Edda and Eldfisk, are brought into production and when facilities for handling natural gas liquids are finished at the Teesside Terminal in England. Labor and material delivery problems prevented completion of the facilities in 1978.

Natural gas production from the Ekofisk area fields, which began in 1977, averaged 948 million cubic feet a day. Phillips share of this production averaged 313 million cubic feet a day. The gas is being sold to a consortium of German, Dutch, Belgian and French transmission and distribution companies.

The Phillips Group's total investment in the Greater Ekofisk Development is \$5.5 billion. The Company's portion is some \$1.3 billion. The Ekofisk investment includes an offshore production and processing complex, two undersea pipelines, a 106-room quarters platform and shore facilities in West Germany and England.





Oil and gas interests in Western Europe (see map on adjacent page) dominate Phillips international operations. A tanker docking at Teesside Terminal in England will receive oil pipelined from the Ekofisk complex in the North Sea. Northeast of Ekofisk, Phillips is developing the Maureen oil field. Also in 1978, an oil find was made offshore Ireland.

Ten miles west of Ekofisk, a second discovery was made in Block 1/9 and confirmed by evaluation drilling. The well tested 3,700 barrels of oil per day and 23 million cubic feet of gas per day. Phillips has a 26% interest in the field, operated by Statoil, the Norwegian state oil company. More drilling is planned.

United Kingdom

In early 1979 Phillips received government approval of a plan to develop the Maureen Field in the United Kingdom sector of the North Sea about 160 miles northeast of Aberdeen, Scotland. Phillips holds a 34% interest in the field.

On the Toni-Thelma discovery block in the United Kingdom sector of the North Sea, Phillips completed two appraisal wells that tested at between 3,000 and 6,000 barrels of crude oil a day. Evaluation drilling is continuing and studies are under way to develop the area. Phillips holds a 35% interest in this discovery block.

In the Hewett area fields, Phillips continued development drilling to maintain production at levels required under contract with British gas utilities. Production attributable to the Company's 19% interest in the Hewett and North-of-Hewett fields averaged 106 million cubic feet of gas a day.

Ireland

Phillips made a non-commercial discovery of oil in the Atlantic Ocean off the coast of Ireland. The discovery was made 95 miles off the nation's west coast in 1,400 feet of water. More exploration is planned for 1979. Phillips is the operator and has a 37.5% interest in the four-company group exploring a 250,000-acre tract.

Some 25 miles east of the discovery, Phillips has options on nine deep-water blocks encompassing 556,000 acres. Phillips and its co-venturers have exclusive rights to evaluate these blocks and to select four of them for exploration.

Africa

Production attributable to Phillips 22.5% interest in Nigeria in 1978 averaged 40,600 barrels a day. This was 5% higher than in 1977. During the year two new oil fields were discovered: one was two miles offshore and the other 25 miles inland in the Niger River Delta. Drilling will continue in both areas.

On Phillips full-interest Gilli-Gilli Field in Nigeria, production was scheduled to begin by mid-1979. Production is expected to average about 3,400 barrels a day.

Agreements were reached with four other companies and the Nigerian National Petroleum Corporation to make Phillips the technical leader and 7.5% owner of a corporation which may construct a large liquefied natural gas and natural gas liquids plant near Bonny, Nigeria, using a Phillips developed process.

In Ghana, Phillips made an oil discovery 20 miles offshore. Additional study needs to be made to determine if the discovery is of commercial value. At year-end, a second wildcat well was being drilled 15 miles south in 3,000 feet of water by the *Discoverer Seven Seas*, a deep-water drillship. Phillips is the operator on 3.3 million acres in Ghana, where it has a 50% interest in an oil prospecting license.

The Seagap Group, of which Phillips is a member, completed an exploratory well in 4,350 feet of water off the shore of the Congo, setting a new deep-water drilling record. The well was a dry hole, but it demonstrated that drilling can be done in areas once thought too deep for exploration.

Phillips began drilling a well off the coast of Morocco in 1978. The Company also entered a 100% concession with the Moroccan government oil company covering 1.9 million onshore acres in northern Morocco. Drilling will begin in 1979.

Indonesia

Phillips share of production from two contract areas in Indonesia averaged 18,300 barrels of oil a day in 1978. Production attributable to Phillips interest in Salawati Island, part of the 3.7 million-acre Teluk Berau contract area, averaged 14,600 barrels a day. In Northeast Kalimantan (formerly Borneo), Phillips share of production averaged 3,700 barrels of oil a day. More wells are planned on this two million-acre contract area.

Exploration on the two contract areas in Indonesia produced one non-commercial oil discovery and several encouraging shows of oil and natural gas.

South America

In Bolivia two dry holes resulted from exploration in a 2.6 million-acre block. Phillips began



Silhouetted in twilight, the drillship Discoverer Seven Seas sinks a well in 3,000 feet of water off the coast of Ghana. The well will help the Company evaluate an oil discovery made nearby in 1978. During the year, the drillship set a new deep-water drilling record by completing a well in 4,350 feet of water.

drilling a third well at year-end. Drilling also continued in central Colombia, where the Company has one well drilling. The Company also is evaluating new South American areas and negotiating for acreage in several countries.

Other Exploratory Areas

Phillips has varying interests in exploratory prospects in northwest Australia, in the waters off the southern coast of New Zealand and off the coast of Spain in the Mediterranean Sea and the Bay of Biscay. One dry hole was drilled in the New Zealand prospect.

In the Philippines the Company obtained drilling rights on a 1.8 million-acre tract in the Visayan Sea. Exploratory drilling will begin in 1979.

NET OIL AND GAS ACREAGE AT YEAR-END

UNITED STATES

Total	6,090,000
Producing	1,250,000

OUTSIDE UNITED STATES

Canada	2,627,000
Latin America	20,285,000
Europe	1,387,000
Africa	15,244,000
Middle East	19,000
Southeast Asia	5,274,000
New Zealand and Australia	22,527,000
Total outside U. S.	67,363,000
Producing outside U. S.	136,000

Coal

By acquiring new leases and making more detailed studies of holdings, Phillips increased the estimate of its lignite coal reserves to some eight billion tons, double the previous estimate. The coal lands include 920,000 acres, mainly in Texas, Arkansas, Tennessee, Louisiana, Alabama and Mississippi. The location of Phillips coal reserves make them well suited to serve virtually all the major Gulf Coast electrical utilities.

During the year Phillips entered into a contract with Cajun Electric Power Cooperative, Inc., to supply the Louisiana utility with 4.8 million tons of lignite a year beginning in late 1984. Cajun plans to build one power plant with two generating units near Phillips lignite reserves 40 miles southeast of Shreveport, Louisiana. Over the life of the contract, Phillips will provide the utility with up to 150 million tons of lignite.

Uranium

Surface facilities on Phillips uranium mining venture in northwestern New Mexico are essentially complete. Production and vent shafts, which were about one-third complete at year-end, are projected to reach the target depth of 3,400 feet in 1980. Sinking of a second production shaft is also under way.

First production of the more than 25 million pounds of yellowcake (uranium oxide ore) is scheduled for 1981. Full production, expected in late 1984, will yield approximately two million pounds of yellowcake a year.

During 1978 Phillips signed its first contract to sell uranium. The contract, with Philadelphia Electric Co., calls for delivery of six million pounds of yellowcake over 12 years beginning in 1983.

Phillips is exploring for more uranium reserves and at year-end held 1,732,000 acres of prospective lands in nine western states.

Geothermal

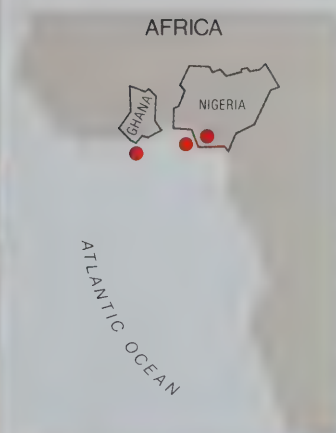
Phillips is drilling the first of two proposed wells in western Nevada in an attempt to find deeper and hotter reservoirs below shallow discoveries. The wells are in conjunction with a Department of Energy program.

At the Company's geothermal discoveries in southwestern Utah, a reservoir is being tested to determine whether it is sufficiently large and reliable for electric power generation.

Outlook

Phillips production of petroleum liquids and natural gas is expected to continue rising in 1979 as a result of further increases in output from the Norwegian North Sea. Domestic oil production will remain about the same, while natural gas and natural gas liquids production will continue a slow decline. The downtrend in natural gas production may be tempered by increased development drilling brought on by higher prices.

Key areas of the Company's exploratory effort in 1979 are Alaska, the Gulf of Mexico, the Canadian Arctic, the North Sea and areas of the Far East. In energy minerals, Phillips will maintain a strong exploration program in uranium and coal, coupled with a vigorous effort to seek out markets for these fuels.



A roadway of water was cut through the marshy terrain of southern Nigeria to make way for the Swampmaster barge to drill the Azuzuama No. 2 well. The probe is a follow-up to one of two part-interest oil strikes made in Nigeria in 1978. Elsewhere in Africa, a discovery was made offshore Ghana.

NET INCOME	1978	1977
	(millions of dollars)	
Petroleum refining, marketing and transportation	\$39	\$72
Equity in earnings of nonsubsidiary companies	9	(9)
	<u>\$48</u>	<u>\$63</u>

The Petroleum Products Group continued its efforts to increase the profitability of refining operations, improve the crude transportation system and streamline the marketing network. Despite these efforts, higher raw material and operating costs, plus a significant drop in liquefied petroleum gas (LPG) prices and sales, held earnings well below the 1977 level. Although sales of gasoline and distillates increased markedly, overall petroleum product sales decreased because of lower LPG volumes.

Feedstock Supplies

Crude oil produced in the United States accounted for 68% of the group's domestic refinery runs, compared with 67% in 1977. The bulk of imported supplies came from Nigeria, while lesser amounts came from the North Sea, Algeria and Libya. In addition, Phillips began importing crude oil from Mexico for the first time.

Contracts for construction of six tankers, each having the capacity to carry 51,000 deadweight tons, or about 380,000 barrels of crude oil, were negotiated with Japanese shipyards. The tankers, which will be delivered in 1979 and 1980, will move oil from Mexico and the Caribbean trans-shipment terminals to the Company's terminal at Freeport, Texas. The tankers will replace, at a substantial savings in operating costs, older and less efficient chartered ships that carry in the range of 35,000 deadweight tons of crude oil.

Each new tanker is designed so that it can be separated and additional sections added to increase carrying capacity by nearly a third. The Company will be able to utilize the additional capacity in the mid '80s, when a deepening of the channel into Freeport Terminal is scheduled to be completed.

In anticipation of the need to bring foreign crude oil into the Borger, Texas, refinery, the Company reversed the flow in a pipeline that in the past carried oil from West Texas to a terminal near Cushing, Oklahoma. Reversing the line allows the Company to move imported crude oil from Freeport Terminal to Cushing and then to the Borger refinery.

Refinery Operations

Modernization and expansion of the refinery in Sweeny, Texas, moved along on schedule. Completion is set for mid-1980. In addition to nearly doubling the refinery's capacity, the improvements will facilitate the processing of heavier and higher sulfur crude oils which make up an increasing portion of the world's supply. At the same time, the modernized refinery will produce more high-value products from each barrel of feedstock.

Phillips domestic refineries operated at 93% of capacity, compared to an industry average of 88%. The refineries generally operated at optimum rates as allowed by crude quality and downtimes for essential maintenance.

CRUDE OIL CAPACITIES AND RUNS — 1978	Average Barrels Daily	
	Capacity*	Runs
REFINERY		
Sweeny, Texas	104,000	99,000
Borger, Texas	100,000	96,000
Kansas City, Kansas	90,000	77,000
Woods Cross, Utah	23,000	24,000
Great Falls, Montana	6,000	6,000
Total	323,000	302,000

*Barrels per day when all process units are in full operation.

In addition to crude oil, natural gas liquids (NGL) are processed at the Borger and Sweeny refineries. Daily NGL processing rates averaged 87,000 barrels at Borger and 51,000 barrels at Sweeny. Significantly smaller quantities of NGL were processed in 1978 than in the previous year, primarily because of a fire in July at the Company's Borger refinery.

Cost of crude oil delivered to our U.S. refineries averaged \$13.52 a barrel in 1978, a 6%

petroleum products



Hoisted into position and tethered by cables, a 13-story distillation column looms above the construction scene at a major expansion of the Sweeny, Texas, refinery. When completed in mid-1980, the expansion will almost double the refinery's crude capacity.

increase over 1977. The average cost was raised 68 cents a barrel as a result of the federal entitlements program implemented in 1974 to equalize the cost of crude to all refiners. NGL cost increased around 13%, to \$7.29 a barrel.

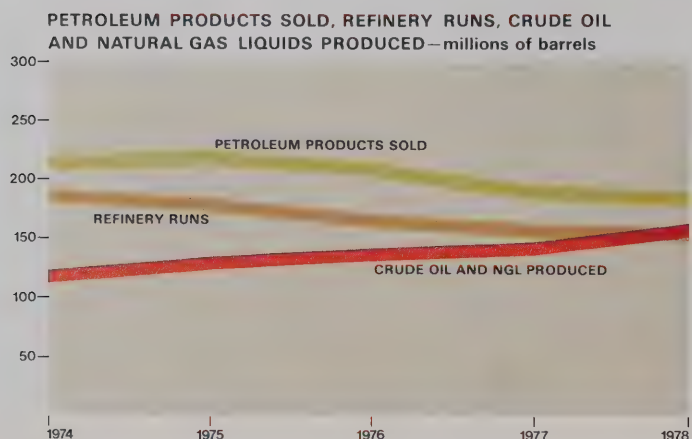
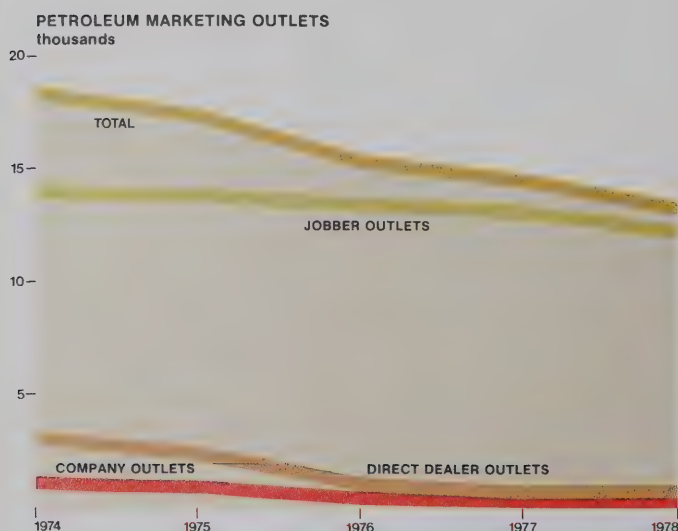
Average percentages of feedstocks processed and products produced in domestic refinery operations during 1978 were:

FEEDSTOCKS		OUTPUT	
Domestic crude oil ..	44%	Motor fuels	42%
Imported crude oil ..	20%	Chemical feedstocks .	12%
Natural gas liquids ..	30%	Distillates	22%
Miscellaneous		Consumer LPG	16%
hydrocarbons	6%	Other products	8%

Marketing Operations

Product revenues increased 3% over 1977, reflecting higher prices and sales for the principal refined products. Sales volume increased for gasoline and distillates, but decreased for LPG.

PETROLEUM PRODUCTS SOLD	Average Barrels Daily	
	1978	1977
UNITED STATES		
Automotive gasoline	250,000	237,000
Liquefied petroleum gas	92,000	119,000
Distillates	82,000	72,000
Aviation fuels	27,000	26,000
Other products	32,000	37,000
Total U. S.	483,000	491,000
Outside U. S.	33,000	41,000
WORLDWIDE	516,000	532,000



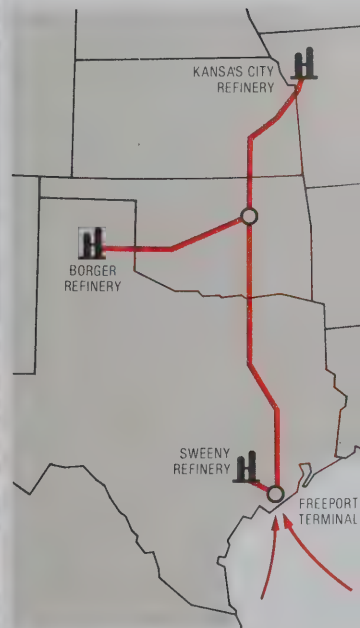
Rising raw material and operating costs forced higher prices on all products except propane and butane. Nevertheless, competition held prices for gasoline, aviation gasoline, commercial turbine fuel and LPG products below levels allowed under government price controls. The Company's average wholesale prices increased 5.3% for gasoline and 5.4% for distillates. However, profit margins were lower due to increased costs. Excessive supplies of LPG forced average prices down 6.5%.

Working cooperatively with jobbers and dealers, Phillips continued to stress improved efficiency and higher sales volumes in service station operations. A total of 1,094 marginal marketing outlets were closed or sold in 1978.

Outlook

Sales volume of the Company's petroleum products in 1979 is expected to remain about the same as in 1978. Prices are projected to increase, primarily because of higher costs for both domestic and imported crude oil.

On an industry basis, supply conditions may be a major restraint on anticipated demand growth for petroleum products in 1979. Much depends on the availability and price of imported oil, increased energy conservation measures undertaken by the public and U. S. industry, as well as U. S. government actions on the pricing and allocation of crude oil and petroleum products.



The Phillips Mexico, the first of six 51,000-deadweight-ton tankers authorized in 1978, undergoes construction in a Japanese shipyard. The tankers will enable Phillips to import crude oil more efficiently from Mexico and the Caribbean. From the Freeport Terminal on the Texas Gulf Coast the crude will move by pipeline to Phillips three major refineries.

NET INCOME	1978	1977
	(millions of dollars)	
Chemicals	\$59	\$68
Equity in earnings of nonsubsidiary companies	1	7
	<u>\$60</u>	<u>\$75</u>

Earnings from chemical operations accounted for 8% of total Company earnings in 1978, compared with 13% in 1977.

Revenues from the Company's worldwide Chemicals Group increased in 1978. However, earnings fell below the prior year's level because raw material and operating costs increased at a higher rate than product prices. In addition, earnings from the Company's nonsubsidiary chemical interests were adversely affected by foreign currency translation losses.

An expansion and modernization program continued in 1978. This program focuses primarily on petrochemical feedstocks and plastics. These are areas where Phillips is firmly established either because of feedstock self-sufficiency, technology or marketing know-how.

In 1978 two major expansion projects were completed: a new ethylene unit at the Company's Sweeny, Texas, refinery and petrochemical complex, and additional polyethylene capacity at Phillips Adams Terminal facility near Houston, Texas.

The new ethylene unit at the Sweeny refinery doubled Phillips production capacity to two billion pounds a year. Building the unit was the final stage of a complex construction program involving 13 cryogenic plants in five states and more than 2,000 miles of pipeline. These plants furnish the ethane needed to make ethylene. The entire project took four years to complete and cost in excess of \$300 million. Phillips expanded ethylene capacity will help the Company meet the nation's demand for this important petrochemical product, which is growing at the rate of 6% to 7% a year.

The other major expansion increased the Company's polyethylene production capacity by 310 million pounds a year, a 56% increase. The enlarged plant raised the Company's capacity to produce both high-density and low-density polyethylene. An additional 90 million pounds a year capacity is scheduled for completion in 1979.

Basic Petrochemicals and Specialty Chemicals

Phillips is one of the nation's largest producers of ethylene, a basic petrochemical. This and other basic petrochemicals, along with specialty chemicals, accounted for a large share of the group's increased sales revenues in 1978. Sales volume of basic petrochemicals increased and prices were slightly higher than in 1977.

In Puerto Rico the Company's manufacturing complex near Guayama operated at 85% of capacity, partly because the facility's principal raw material, naphtha, was in limited supply during the year. The complex makes a variety of petrochemicals and gasoline.

In specialty chemicals, the Company achieved higher production levels and was able to receive prices that covered increased operating and raw material costs.

Phillips and another company formed Custom Oil Recovery Technology Company (CORT). This company provides enhanced oil recovery systems to the oil producers. CORT will market enhanced recovery technology and associated products.

Plastics

Markets for our principal plastic resins, especially Marlex polyethylene, remained strong. Sales volume increased 12% in 1978, but this gain was offset by lower prices and start-up costs of the new manufacturing facilities at Adams Terminal.

Phillips acquired an additional 20% interest in a high-density polyethylene plant near Antwerp, Belgium, bringing its ownership to 50%.

In 1978 the Company continued to broaden its U. S. and international markets for its line of Ryton polyphenylene sulfide products. As a result, sales volume rose 15% and prices throughout the year were slightly higher than a year ago. Ryton is a heat and corrosion-resistant plastic that is being used in automobiles, electronic components and small appliances.

Despite a limited supply of product, markets were expanded for K-Resin, a clear shatter-resistant plastic. To increase supply, a new 120 million pounds a year K-Resin plant is scheduled for completion at Adams Terminal in 1979.

chemicals



Clarity, lightness and resistance to shattering are properties that helped Phillips K-Resin plastic win out over glass and other plastics for use in turn-of-the-century candy containers. Phillips is increasing its capability to produce this plastic with a 120 million pounds a year plant expansion.

Rubber Chemicals

Sales were strong for the Company's Philprene, Solprene and Cis-4 rubbers. However, margins decreased because prices did not keep pace with cost increases.

Worldwide demand increased for Philblack carbon black, a rubber reinforcing agent. U. S. market prices were flat until mid-year, then prices improved moderately, allowing some recovery of increased costs.

The Phillips carbon black process was licensed for use in Thailand's first carbon black facility.

Consumer Products

Results were mixed for the Chemicals Group subsidiaries which produce and market such goods as fabricated plastic and paper products. Overall, sales revenues for these products increased 12% in 1978.

Phillips Driscopipe, Inc., a producer of plastic pipe, recorded higher sales. All five pipe plants operated at capacity and a new pipe plant in South Carolina will be completed in late 1979.

The product lines of Phillips Products Co., Inc., continued to expand. Garden Scene plastic planterware introduced new styles, colors and designs. New finishing facilities for the successful line of plastic shutters were installed at the Cambridge, Ohio, plant.

Sealright Co., Inc., experienced continued growth of Convocan and Ultrakan in-plant container and fabrication machinery systems. Sealright manufactures paperboard and plastic containers and related packaging machinery for consumer and industrial products.

H. P. Smith Paper Co., a plastic film and paper coating subsidiary, recorded higher sales as new equipment was put into operation to expand the company's production of Polyslik release paper.

Fertilizers

Phillips nitrogen fertilizer business was depressed in 1978. In the Midwest, demand was lower because of heavy rains during the spring

planting season. Some imports of ammonia from Russia added to the excess supply, which lowered prices. Fertilizer demand strengthened in the Pacific Northwest, reflecting that area's recovery from the severe 1977 drought.

Fibers

Phillips fibers operations had a 4% decrease in sales revenues in 1978. Product prices were generally higher.

Olefin filament sales were particularly strong for the furniture upholstery market. There also was growing use of staple fiber in fabrics for trunk linings and interior trim in automobiles.

Markets for non-woven fabrics made by Phillips Fibers Corporation continued to expand. Major gains were made in civil engineering applications, including road paving underlay, soil stabilization and drainage.

Outlook

Phillips anticipates that prices for most chemicals will keep pace with rising raw material and operating costs in 1979. Demand for most products is expected to continue to grow. While overcapacity has been a chronic problem in the chemical industry, the Company believes it is expanding in areas where markets are strongest. As an example, the Company's production of K-Resin plastic resin, which is undergoing expansion, has been sold out since 1977 and the 1978 expansion of Phillips domestic ethylene capacity is fully committed to outside companies.

The Chemicals Group's long-term strategy is to expand product lines that can grow at an average annual rate in excess of the general economy as measured by the gross national product. Current products that fall within this category include chemical feedstocks, Marlex high-density polyethylene, plastic pipe and specialty chemicals, namely sulfur-based hydrocarbons and highly refined LP-gases. In addition, the Company will continue to seek out new products that appear to have similar future growth potential.



One billion pounds of ethylene can be produced each year through a new olefin unit at Sweeny, Texas. The unit doubled Phillips domestic ethylene capacity while using 30 percent less energy than the Company's existing units.

PRINCIPAL CHEMICAL PLANT EXPANSIONS

PRODUCT	LOCATION	PHILLIPS INTEREST	ADDITIONAL GROSS ANNUAL CAPACITY
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COMPLETED DURING 1978

Ethylene	Sweeny, Texas	100%	1,000,000,000 pounds
Tertiary mercaptan	Borger, Texas	100%	7,000,000 pounds
High-density polyethylene*	Houston, Texas	100%	310,000,000 pounds
Propylene	Sweeny, Texas	100%	140,600,000 pounds
Carbon black	Ravenna, Italy	50%	11,000,000 pounds

UNDER CONSTRUCTION OR AUTHORIZED AT YEAR-END

Petosulfur compound†	Tessenderlo, Belgium	100%	22,100,000 pounds
Benzene	Guayama, Puerto Rico	100%	12,000,000 gallons
High-density polyethylene*	Houston, Texas	100%	90,000,000 pounds
Butadiene-styrene†	Borger, Texas	100%	120,000,000 pounds
Polypropylene	Houston, Texas	100%	10,000,000 pounds
Butadiene	Puertollano, Spain	45%	110,200,000 pounds
Synthetic rubber	Borger, Texas	100%	23,100,000 pounds
Carbon black	Borger, Texas	100%	33,000,000 pounds
Carbon black	Toledo, Ohio	100%	23,500,000 pounds

*Plant can also produce low-density polyethylene.

†New Plant

Completion of additional laboratory and conference facilities at the Bartlesville Research Center exemplified the Company's continuing commitment to petroleum and petrochemical research. In 1979 the Company will begin building a new research library, a geoscience building and a major multi-purpose pilot plant building. During 1978, progress was made on a broad range of research fronts.

Petroleum Exploration and Production

Alkaline polymerflooding, combining two substances previously used separately in waterflood oil recovery, proved highly successful in laboratory tests. Sodium carbonate, an alkali, is injected with water and acts to free trapped oil. A high molecular weight polymer thickens the water and creates an oil pushing effect. A 450-day field test project is scheduled to start in 1979. If successful, this method may be used in a number of Phillips enhanced oil recovery projects.

Company researchers have developed a method to provide same-day evaluation on data of underground rock formations in exploratory drilling. This new technology, high fidelity sonic waveform logging, has been tested successfully in the Texas Panhandle. Additional tests are being made in 1979 in several areas. The sonic waveform instruments and a companion computer are packaged inside a van-type truck and therefore can be easily moved to most drilling sites.

Phillips scientists are applying a complex geological technique to an information gathering well offshore California. It is called a paleomagnetism procedure. This procedure involves the study of the magnetic field's imprint on rocks. Magnetic particles within rock formations always point toward earth's magnetic pole. Because the magnetic poles have reversed themselves a number of times over millions of years, it is possible to use this procedure to identify rock strata formed in the same geological age.

Fuels and Lube Research

Phillips has successfully applied its Trop-Artic motor oil technology to aircraft engine lubrication. In spring 1979, the Company will market the aviation industry's first 20W-50 multigrade oil. A key ingredient in the new multigrade oil is Phil-Ad VII,

a development that allows oil to maintain proper thickness while operating under either extreme cold or high heat conditions.

A new carburetor detergent for use in gasolines went into a final 12-month field test in mid-1978. It offers the potential for a higher level of carburetor cleanliness at lower cost and is likely to become an ingredient in Phillips gasolines.

An improved motor oil additive, Phil-Ad 300, has demonstrated its effectiveness and reliability in an extended life motor oil formulation which will maintain engine protection for at least 15,000 miles. Field testing will continue pending the start of full-scale production of the new additive.

Products and Processes

Recent carbon black research produced two new types of reactors. At Orange, Texas, a new reactor began producing improved hard blacks for use in today's high-mileage tires. At Borger, Texas, a new soft black reactor is scheduled to begin operation in 1979, allowing production of existing grades at greatly increased efficiency and the marketing of a grade widely used in specialty rubber goods, such as automotive and industrial V-belts. It will operate in conjunction with an experimental energy recovery system which captures much of the reactor's heat for other uses.

A new method of producing rubber, now in the pilot plant stage of development, shows excellent potential in reducing both investment costs and energy requirements compared to the presently used process. It eliminates large volumes of water in producing rubber by making use of a new evaporator system to separate the rubber from its reaction mixture.

A plastics-modifying agent, Solprene 312, was developed which has excellent potential for use in automotive body parts. This material, when added to fiberglass-reinforced plastic body parts, such as decks and lids, increases impact resistance and improves surface appearance.

Patents and Licensing

For the eleventh consecutive year, Phillips led the petroleum industry in U. S. patents obtained with 330. At year-end, the Company owned 6,284 active U. S. patents and 3,103 active patents in other countries. Licenses for Phillips technology have now been granted in more than 30 countries.

research



Phillips technicians at a Company drilling rig test an important innovation in exploration research. Their research van houses a computer capable of identifying 183 kinds of underground rock from sound waves picked up by a sensitive instrument in the drill hole.

The Company was involved in a variety of public interest activities in 1978 as part of its effort to be a good neighbor in every country where it operates and a respected corporate citizen in every community where there are Phillips people.

Economic Education

The *American Enterprise* economic history film series, now in its third year, experienced a 55% increase in demand in 1978. More than half of all U. S. secondary schools have used the five films, which reach more than one million student viewers per month. *American Enterprise Teaching Notes*, a periodic newsletter that complements the film series, is received by 55,000 teachers.

In association with the 5,800-chapter Distributive Education Clubs of America (DECA) organization, the Company sponsored a private enterprise project competition for high school students. Several thousand students participated in either a chapter or individual project, competing for awards at state and national levels.

Youth and Community Service

Striving to assist in a stronger 1980 U. S. Olympic effort, Phillips has added sponsorship of U. S. Amateur Athletic Union diving competition to the Company's long-time support of amateur swimming. In 1978 swim clinics were organized and sponsored in 15 U. S. cities with more than 5,000 young people participating. National coaching clinics were held in Indonesia, Singapore and the Philippines in a continuing effort to boost amateur swimming worldwide, particularly in countries where Phillips operates.

Nearly 100 Phillips people were recognized in the Company's Distinguished Community Service Award program in 1978. More than 700 employees have been honored for volunteer service in their community since the program began in mid-1974.

Total contributions during 1978 to educational, health, cultural, youth, community and public interest organizations exceeded \$3 million, a 40% increase over 1977. Support to colleges and universities made up more than \$1.5 million of the total. A substantial contribution was made to support the building of a much needed community center in Phillips hometown of Bartlesville, Okla.

Energy Conservation

Phillips rate of energy consumption has been cut by 18% since a conservation program was

formalized in 1973. Total energy savings in 1978 alone would provide fuel and electricity for 265,000 average-sized homes for a year.

Major energy savings were achieved in 1978 through process changes at Adams Terminal petrochemical complex near Houston, which conserved energy equivalent to more than 50,000 barrels of oil a year. Also, installation of improved operating controls at refining units in Guayama, Puerto Rico, and Borger, Texas, saved energy equal to nearly 200,000 barrels of oil annually.

Phillips refineries are approaching the Department of Energy's goal of a 20% energy savings in U. S. refining operations. The Company's chemical plants have far exceeded the petrochemical industry's target savings rate of 17%. These reductions are calculated from a 1972 base.

Environmental Protection

Capital expenditures committed to environmental protection during 1978 totaled \$98 million. Another \$61 million was spent to operate and maintain existing environmental controls.

At the Sweeny, Texas, refinery, where capacity is being nearly doubled, a complex program is under way to assure that the expansions will not increase overall hydrocarbon emissions.

Efforts to upgrade wastewater discharges from existing facilities continued. A new effluent filtering system at the treater plant serving the Borger, Texas, refinery and the nearby specialty chemicals plant resulted in a more consistent quality in the wastewater stream.

A subsidiary, Phillips Coal Company, is determining the best methods for land reclamation in Louisiana, although lignite coal mining operations will not begin until 1984. Strip-mined land must be restored to beneficial use, and early test plantings of Bermuda grass, hardwood trees and soybeans indicate that full restoration is feasible.

Another plant using the Phillips Re-Refined Oil Process (PROP) is scheduled to be delivered in 1979 to a Canadian oil marketer. The plant will be able to recycle some five million gallons of waste oil a year into a high-quality, lubricating oil base stock. PROP plants re-refine used motor oil faster than any other methods available. The PROP plants also overcome severe environmental objections associated with older processes.

corporate citizenship



At the site of a future lignite coal mine in Louisiana, a Phillips botanist checks soybeans grown on test plots where the surface has been excavated and restored.



In support of amateur swimming and diving, Phillips sponsors clinics for athletes and coaches and underwrites national and international meets. Characteristics of employee volunteer efforts, mechanic Wayne Miller (right) helped organize a Kansas community mental retardation center.



Employment rose 6%, reflecting growth primarily in technical and scientific activities. By year-end, 30,000 people were working for Phillips. Of the 4,600 working abroad, 85% were citizens of the countries where they were employed.

As is true in many companies, women are filling an increasing number of jobs within the Phillips organization. In 1978 women accounted for 21% of the Company's U. S. work force. Members of racial minorities accounted for 13% of Phillips U. S. employees.

Company representatives visiting college campuses continued to recruit the best qualified students seeking careers in the energy and chemical fields. In addition, more colleges and universities were included in the Phillips recruitment program. Most graduates hired were in the fields of business, engineering and science.

Labor relations remained good. No significant work stoppages were experienced in the Company's basic petroleum and petrochemical operations. Some smaller subsidiaries experienced strikes ranging in duration from a few days to several weeks. Labor problems with construction workers in the United Kingdom contributed to the delay in completion of natural gas liquids facilities at Teesside Terminal.

Employee Development and Performance

A new in-house seminar program for executive development was introduced. Some 60 executives were involved in the intensive, four-week seminar. The program is designed to provide middle-level managers with a broader awareness of business and management principles and an increased understanding of how external influences affect the Company's performance.

Employees again increased their participation in training courses offered by both the Company and academic institutions. More than 850 employees received financial support from our educational assistance plans to enroll in college or university courses.

Using computer systems, the Company further refined programs designed to identify and develop employees' abilities, as well as identify career development assignments.

Phillips accelerated a companywide effort to improve productivity, as one way to help combat

inflation. This strategy, which also helps improve our competitive position, focuses on increasing the output of goods and services without a corresponding increase in resources used. Productivity is measured relative to materials used, capital employed, energy consumed and labor costs. Objectives for improvement in those four categories are set and monitored.

In addition, the Company has set up a new operations audit program, similar to its internal financial audits. However, in this case the auditors are looking to see if the Company's businesses are being operated as efficiently as possible, thereby identifying areas in which productivity or performance can be improved.

Employees submitted more than 15,000 improvement ideas to Suggestion Plan administrators in 1978. More than 3,500 suggestions were adopted amounting to \$431,190 in cash awards. They produced tangible savings in the first year for the Company exceeding \$4 million.

Phillips employee benefits communication program was recognized by an international organization of business communicators as the foremost program of its type in American industry. The *Your Extra Security (YES)* program utilizes videotapes, exhibits and printed material to provide information to employees on Company benefits. During the year, the cost for employee benefits averaged \$7,000 for each Company employee, 12% higher than in 1977.

Safety and Health

The *lost work day incident rate* was 0.79 per 200,000 manhours worked. The *vehicle accident rate* was 3.11 per million miles driven. Both rates were lower than industry averages. However, physical losses due to fires and accidents were at an unacceptable level. Additional specific programs, safety audits, training and special accident prevention courses were instituted during the year to reduce such losses in the future.

Efforts to assure that working conditions are safe from exposure to toxic substances continued to receive a high priority from management. Teams of physicians, hygienists and medical technicians continued to conduct plant site monitoring and tests, including examinations of individual employees. Results showed no serious exposures nor work-related illnesses.

people



Fish, cheese, cold cuts, fruit and vegetables make up just the appetizers of a meal in the dining hall of Phillips new "Ekotisk Hotel" in the North Sea. The 106-room quarters platform provides a theater, lounges, reading, music and game rooms and a hospital.

FIVE YEAR SUMMARY OF NET INCOME

	1978	1977	1976	1975	1974
			(millions of dollars)		
Petroleum exploration and production					
United States	\$278	\$261	\$199	\$179	\$198
Outside United States	137	90	43	59	58
	<u>415</u>	<u>351</u>	<u>242</u>	<u>238</u>	<u>256</u>
Petroleum refining, marketing and transportation					
United States	34	60	55	5	(13)
Outside United States	5	12	1	(2)	(10)
	<u>39</u>	<u>72</u>	<u>56</u>	<u>3</u>	<u>(23)</u>
Worldwide chemicals	59	68	74	81	152
Other*	197	26	40	21	45
	<u>\$710</u>	<u>\$517</u>	<u>\$412</u>	<u>\$343</u>	<u>\$430[†]</u>

*Other includes equity in earnings of nonsubsidiary companies, coal, uranium and geothermal and other corporate (including in 1978 a gain of \$170 million from sale of Pacific Petroleum Ltd. stock).

[†]Before cumulative effect of accounting change.

MANAGEMENT'S DISCUSSION OF 1978 EARNINGS

The Company's net income for 1978 was \$710,479,000, up \$193,577,000 from 1977 earnings of \$516,902,000 and included a one-time gain of \$169,901,000 or \$1.10 a share from sale of the Company's 48.2% interest in Pacific Petroleum Ltd. Excluding this gain, net income increased \$23,676,000 or 14 cents a share from the \$3.37 a share reported in 1977. Contributing to this increase was a \$31,226,000 rise in petroleum earnings and a \$1,142,000 improvement in other operations, which were partially offset by an \$8,692,000 decrease in chemical earnings.

Net income for petroleum operations improved because of higher worldwide production of crude oil and natural gas and improved natural gas sales prices, offset in part by greater exploration costs, lower average crude oil sales prices and a decline in earnings for refining, marketing and transportation operations.

Chemical earnings declined in 1978 as price increases were insufficient to recover higher raw material costs and operating expenses.

Revenues

Sales and other operating revenues increased \$713,597,000 or 11% because of a \$593,817,000 or 12% increase in petroleum revenues and an improvement of \$110,429,000 or 9% in chemical sales. Petroleum revenues rose as the result of a 17% increase in worldwide crude oil production, a 15% increase in worldwide natural gas produc-

tion and higher sales prices for natural gas and motor fuel. The increase in crude oil output came from the Norwegian North Sea, Indonesia, Nigeria and the North Slope of Alaska. Natural gas production rose principally as the result of a full year's gas sales from Ekofisk. Negative effects on 1978 revenues included lower average crude oil sales prices and reduced sales volume and prices for liquefied petroleum gas.

Revenues from chemical operations improved because of increased volumes for chemical products and plastic resins and higher prices for synthetic rubber, carbon black and ethylene. Negative factors were lower sales prices for plastic resins and fertilizer and lower fertilizer volumes.

Costs and Expenses

Total costs and expenses rose \$823,712,000 or 14%. Included in this increase is \$174,500,000 for higher production and operating expenses, mainly the result of higher lifting and transportation costs for crude oil and natural gas as well as increased geological and geophysical expenses. Also included in this increase is \$193,163,000, primarily from increased purchases of domestic crude oil and natural gas, and higher raw material costs for chemicals.

Depreciation, depletion, amortization and retirements increased \$123,759,000 in 1978, 37% higher than in 1977. The increase was caused by greater investment in proved oil and gas

financial review

properties, in undeveloped oil and gas leases and in chemical plants. In addition, higher volumes of oil and gas production increased the amount of depletion.

As a result of the accelerated search for additional energy reserves, including coal, uranium and geothermal in the U. S., costs resulting from unsuccessful exploration increased 32%. A comparison of the components of exploration costs follows:

	1978	1977
Geological and geophysical expenses	\$ 93,775,000	\$ 80,634,000
Amortization of undeveloped leasehold costs	48,217,000	30,477,000
Dry hole costs	100,743,000	70,540,000
Lease rentals	7,842,000	7,823,000
	<u>\$250,577,000</u>	<u>\$189,474,000</u>

Taxes other than income taxes increased \$10,419,000 as gross production and social security taxes rose. Selling, general and administrative expenses decreased \$7,702,000, primarily because of lower expenses in petroleum marketing operations.

The provision for income taxes, excluding taxes resulting from the sale of Pacific stock (\$136,073,000), increased \$196,698,000 to \$866,438,000. Foreign taxes, excluding the Pacific sale, increased \$103,113,000 and U. S., state and local income taxes rose \$93,585,000. Increased foreign income taxes resulted primarily from growth in pre-tax earnings in high income tax rate jurisdictions, plus the effects of foreign currency translations.

Other Comments

The Company's return on average total assets for 1978 was 8.8% excluding the gain on the sale of the Pacific stock, a decline from 9.4% in 1977. Including the gain, the return was 11.6%.

On a geographic basis, income from U. S. operations was \$340,893,000 or 63% of the total, down \$10,238,000 from 1977. Excluding the sale of Pacific, foreign income was \$199,685,000 or 37% of the total, up \$33,914,000 from 1977.

Foreign currency translation losses in 1978 were \$28,070,000 or 18 cents a share as compared with a small gain in 1977, primarily as a result of the decline of the value of the dollar with respect to the Norwegian krone. The Company's exposure to fluctuations in the value of the krone stems from Phillips operations in the Norwegian North Sea.

RETURN ON TOTAL ASSETS*

Phillips return on assets was 8.8% in 1978, excluding the sale of Phillips interest in Pacific Petroleum Ltd. (shaded area). These figures compare with a 9.4% return in 1977. Including the Pacific sale, the return was 11.6%. In 1978 the return on domestic operations was 8.9%, while the return on foreign operations, excluding the Pacific sale, was 8.6%.

*Before cumulative effect of accounting change in 1974.

NET INCOME

Major positive influences on 1978 net income were increased worldwide crude oil and natural gas production, higher natural gas prices and the sale of Phillips interest in Pacific Petroleum Ltd. (shaded area). Negative factors included currency translation losses, higher exploration costs and declines in earnings from petroleum products and chemicals.

FUNDS AVAILABLE AND EXPENDED

Funds generated from operations totaled \$1,120,800,000 in 1978, a 14% increase over 1977. The deficiency between generated funds and capital expenditures, dividends, debt repayment and operating costs was made up primarily by the sale of investments and assets.

CAPITAL EXPENDITURES

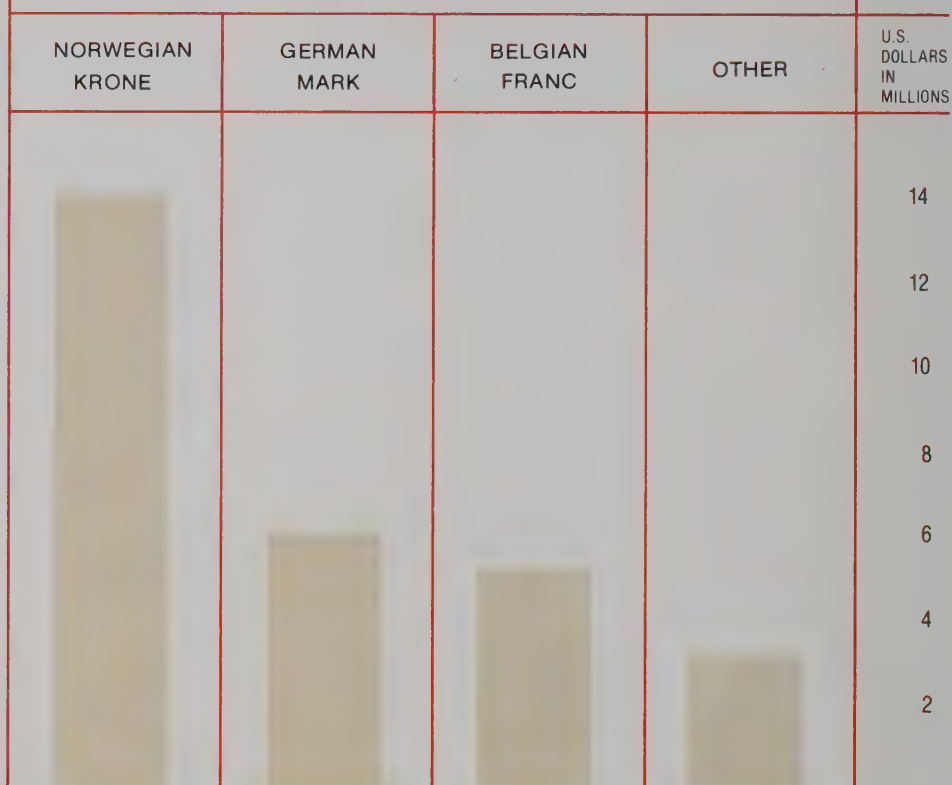
A total of \$974,900,000 was spent by Phillips for capital expenditures during 1978. This represents a 14% decline from 1977 expenditures, which included a substantial outlay for purchase of federal offshore leases. Expenditures in the U. S. totaled \$605,700,000, while foreign expenditures amounted to \$369,200,000.



FOREIGN CURRENCY TRANSLATION

The majority of the Company's foreign currency translation losses were caused by Norwegian accrued taxes and long-term debt in various currencies associated with the Company's Ekofisk operations. Norwegian taxes are paid quarterly, one year after they occur. When the value of the dollar declines against the Norwegian krone as it did last year, it requires more dollars to pay the accrued Norwegian taxes. This increase is reported as a translation loss. To moderate the impact of foreign currency movements on earnings, Phillips conducts a foreign currency hedging program.

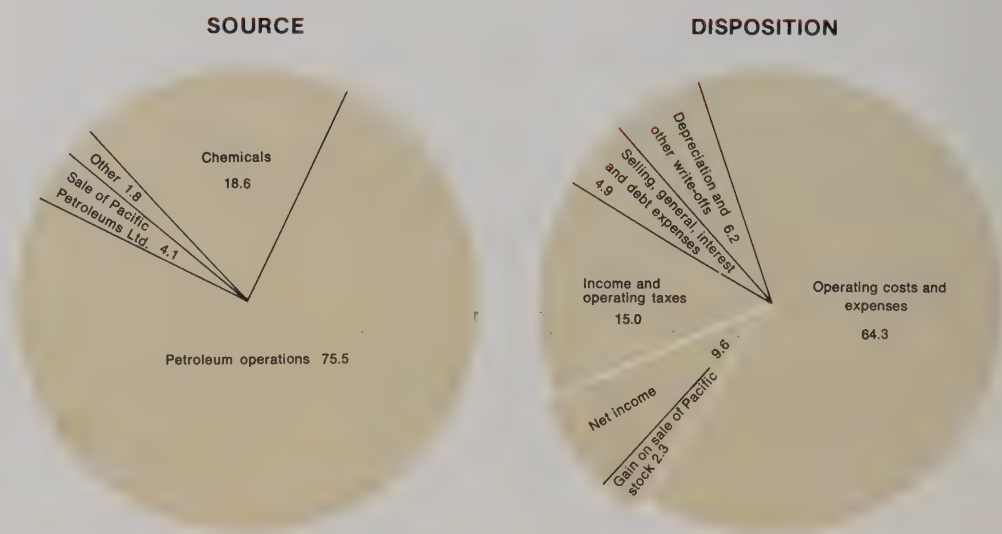
The effects of foreign exchange rate movements during 1978 reduced earnings \$28,100,000. Currency translation losses occur when the value of U. S. dollars decline in relation to currencies of other countries. The graph shows the currencies associated with Phillips 1978 translation losses.



SOURCE	1978	1977
Petroleum operations	75.5¢	78.1¢
Chemicals	18.6	19.9
Sale of Pacific Petroleum Ltd.	4.1	—
Other	1.8	2.0

DISPOSITION	1978	1977
Operating costs and expenses	64.3¢	68.7¢
Income and operating taxes	15.0	12.1
Selling, general, interest and debt expenses	4.9	5.8
Depreciation and other write-offs	6.2	5.3
Net income		
Excluding gain on sale of Pacific stock	7.3	8.1
Gain on sale of Pacific stock	2.3	—
Total	9.6	8.1

SOURCE AND DISPOSITION OF REVENUE DOLLAR



ANALYSIS OF RESULTS By business segment and geographic area

SEGMENT	1978	1977	1976*	1975*	1974*
			(millions of dollars)		
Sales and other operating revenues to outside customers					
Petroleum operations — U. S.	\$4,327	\$4,057	\$3,624	\$3,481	\$2,986
Petroleum operations — outside U. S.	1,274	949	827	579	652
Chemicals	1,384	1,274	1,230	1,058	1,320
Other	13	4	17	16	23
	<u>6,998</u>	<u>6,284</u>	<u>5,698</u>	<u>5,134</u>	<u>4,981</u>
To other segments within Phillips					
Petroleum operations — U. S.	343	321	265	224	247
Petroleum operations — outside U. S.	334	304	246	333	450
Chemicals	152	137	118	122	87
Other	14	2	9	2	5
	<u>843</u>	<u>764</u>	<u>638</u>	<u>681</u>	<u>789</u>
Eliminations (intersegment)	<u>(843)</u>	<u>(764)</u>	<u>(638)</u>	<u>(681)</u>	<u>(789)</u>
Total	<u>\$6,998</u>	<u>\$6,284</u>	<u>\$5,698</u>	<u>\$5,134</u>	<u>\$4,981</u>
Operating profit					
Petroleum operations — U. S.	\$ 630	\$ 625	\$ 503	\$ 377	\$ 384
Petroleum operations — outside U. S.	789	494	450	294	226
Chemicals	84	120	155	161	220
Other	(41)	(32)	(27)	(21)	(8)
Eliminations (intersegment)	2	4	(6)	(5)	(21)
	<u>\$1,464</u>	<u>\$1,211</u>	<u>\$1,075</u>	<u>\$ 806</u>	<u>\$ 801</u>
Net income	<u>\$ 710</u>	<u>\$ 517</u>	<u>\$ 412</u>	<u>\$ 343</u>	<u>\$ 430†</u>
Assets identifiable by business segment					
Petroleum operations — U. S.	\$2,600	\$2,485	\$2,184	\$2,111	\$2,045
Petroleum operations — outside U. S.	1,573	1,373	1,077	891	703
Chemicals	1,039	890	625	639	637
Other	274	180	131	82	72
Eliminations (intersegment)	(16)	(21)	(21)	(16)	(32)
	<u>\$5,470</u>	<u>\$4,907</u>	<u>\$3,996</u>	<u>\$3,707</u>	<u>\$3,425</u>
Depreciation, depletion, amortization and retirements					
Petroleum operations — U. S.	\$ 220	\$ 175	\$ 160	\$ 167	\$ 154
Petroleum operations — outside U. S.	190	108	85	125	74
Chemicals	46	33	54	32	44
Other	9	4	5	4	3
Corporate	(5)	17	—	(2)	(1)
Capital expenditures — properties, plants and equipment					
Petroleum operations — U. S.	\$ 394	\$ 520	\$ 266	\$ 316	\$ 303
Petroleum operations — outside U. S.	347	331	305	302	215
Chemicals	126	161	121	57	68
Other	76	67	28	14	29
Corporate	13	12	8	5	3
GEOGRAPHIC					
Sales and other operating revenues to outside customers					
United States	\$5,551	\$5,175	\$4,647	\$4,374	\$3,966
Europe-Africa	1,254	991	951	582	733
Other	193	118	100	178	282
	<u>6,998</u>	<u>6,284</u>	<u>5,698</u>	<u>5,134</u>	<u>4,981</u>
To other geographic areas					
United States	37	42	39	27	68
Europe-Africa	334	288	219	268	277
Other	3	20	18	63	136
	<u>374</u>	<u>350</u>	<u>276</u>	<u>358</u>	<u>481</u>
Eliminations (intergeographic)	<u>(374)</u>	<u>(350)</u>	<u>(276)</u>	<u>(358)</u>	<u>(481)</u>
Total	<u>\$6,998</u>	<u>\$6,284</u>	<u>\$5,698</u>	<u>\$5,134</u>	<u>\$4,981</u>
Operating profit					
United States	\$ 676	\$ 706	\$ 626	\$ 510	\$ 495
Europe-Africa	792	534	477	294	153
Other	(4)	(32)	(23)	5	164
Eliminations (intergeographic)	—	3	(5)	(3)	(11)
	<u>\$1,464</u>	<u>\$1,211</u>	<u>\$1,075</u>	<u>\$ 806</u>	<u>\$ 801</u>
Net income	<u>\$ 710</u>	<u>\$ 517</u>	<u>\$ 412</u>	<u>\$ 343</u>	<u>\$ 430†</u>
Assets identifiable by geographic area					
United States	\$3,843	\$3,492	\$2,882	\$2,770	\$2,666
Europe-Africa	1,453	1,223	943	699	500
Other	189	210	189	251	269
Eliminations (intergeographic)	(15)	(18)	(18)	(13)	(10)
	<u>\$5,470</u>	<u>\$4,907</u>	<u>\$3,996</u>	<u>\$3,707</u>	<u>\$3,425</u>

*Business segment and geographic area information has not been audited for 1976, 1975 and 1974.

†Before cumulative effect of accounting change.

STOCK PRICES AND DIVIDENDS

Phillips common stock, the Company's only class of voting securities, is traded primarily on the New York Stock Exchange. The table shows the high and low sales prices and the dividends paid for each quarterly period during the past two years for a share of the common stock. On March 1, 1978, the quarterly dividend increased to 30 cents a share.

		QUARTER			
		First	Second	Third	Fourth
PRICE PER SHARE					
1978	High	\$31¼	\$36¾	\$35¾	\$35
	Low	26¾	28¼	31	28⅞
1977*	High	33⅞	32⅞	33⅞	31⅞
	Low	27¾	26	28⅞	27¾
DIVIDENDS PER SHARE					
1978		\$.30	\$.30	\$.30	\$.30
1977*		.22½	.25	.25	.25

*Adjusted for two-for-one stock split on May 7, 1977.

MANAGEMENT'S DISCUSSION OF 1977 EARNINGS

The Company's earnings for 1977 increased \$105,246,000 or 26% over 1976. Of total 1977 earnings, domestic operations accounted for 68% or \$351,131,000, an increase of \$58,166,000 or 20%. Foreign earnings accounted for \$165,771,000 of total earnings, an increase of \$47,080,000 or 40%. Earnings improved partly because of improved prices realized in the Company's worldwide petroleum operations and because of increased production of crude oil and natural gas liquids. In 1977, foreign currency translation gains were immaterial compared to losses of \$37,338,000 in 1976.

Total revenues increased \$568,882,000 or 10%. This was due to an improvement of \$586,669,000 in sales and other operating revenues, primarily the result of higher prices. Other revenues decreased \$13,767,000 mainly due to the sale in 1976 of the assets of certain western operations.

Total costs and expenses increased \$463,636,000 or 9%. Of the total increase, \$214,401,000 is due to higher production and operating expenses and \$171,987,000 is primarily due to increased purchases of crude oil and natural gas. Charges for depreciation, depletion, amortization and re-

tirements increased \$32,712,000. This increase is primarily depreciation of \$32,624,000 of which \$17,417,000 is the result of the capitalization of leases in 1977 in accordance with Financial Accounting Standards Board Statement No. 13 (see Note 7). Taxes other than income taxes increased \$11,426,000 or 12%, principally due to taxes levied on the production of crude oil and natural gas and property taxes. Selling, general and administrative expenses decreased \$30,466,000, primarily due to the capitalization of leases in 1977 and the sale of West Coast refining and marketing properties in 1976. Interest and expense on indebtedness increased \$13,653,000 due to the capitalization of leases in 1977. The provision for income taxes is \$49,923,000 higher with an increase of \$54,888,000 for U. S. taxes partly offset by a decrease of \$4,965,000 for foreign taxes.

Copies of the Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission may be obtained by writing to Mr. Harvey W. Thompson, Secretary, Phillips Petroleum Company, Bartlesville, OK 74004.

PHILLIPS PETROLEUM COMPANY

CONSOLIDATED STATEMENTS OF INCOME AND EARNINGS EMPLOYED IN THE BUSINESS

	1978	1977
	(thousands of dollars)	
Revenues:		
Sales and other operating revenues	\$6,997,782	\$6,284,185
Equity in earnings of nonsubsidiary companies	41,223	40,016
Sale of Pacific Petroleum Ltd. — Note 3	305,974	—
Other revenues	78,133	81,622
	<u>7,423,112</u>	<u>6,405,823</u>
Costs and Expenses:		
Costs and operating expenses	4,771,963	4,404,300
Selling, general and administrative expenses	284,100	291,802
Depreciation, depletion, amortization and retirements	460,461	336,702
Taxes other than income taxes — Note 9	114,852	104,433
Interest and expense on indebtedness	78,746	81,944
Provision for income taxes — Note 9	1,002,511	669,740
	<u>6,712,633</u>	<u>5,888,921</u>
Net Income	710,479	516,902
Earnings Employed in the Business at Beginning of Year	2,406,197	2,038,812
	<u>3,116,676</u>	<u>2,555,714</u>
Dividends Paid (1978 — \$1.20 a share; 1977 — \$.975 a share) — Note 10	184,785	149,517
Earnings Employed in the Business at End of Year	<u>\$2,931,891</u>	<u>\$2,406,197</u>
Net Income Per Share of Common Stock — Note 10	\$ 4.61	\$ 3.37

REPORT OF CERTIFIED PUBLIC ACCOUNTANTS

The Board of Directors and Stockholders
Phillips Petroleum Company

We have examined the accompanying consolidated balance sheets of Phillips Petroleum Company at December 31, 1978 and 1977, and the related consolidated statements of income and earnings employed in the business and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the statements mentioned above present fairly the consolidated financial position of Phillips Petroleum Company at December 31, 1978 and 1977, and the consolidated results of operations and changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis during the period.

Tulsa, Oklahoma
February 19, 1979

Arthur Young & Company

PHILLIPS PETROLEUM COMPANY
CONSOLIDATED BALANCE SHEETS AT DECEMBER 31

ASSETS	1978	1977
Current Assets:	(thousands of dollars)	
Cash, including time deposits — (1978 — \$1,001,098; 1977 — \$197,082)	\$1,104,048	\$ 292,836
Short-term investments	31,521	33,880
Accounts and notes receivable — (less allowances: 1978 — \$15,000; 1977 — \$10,738)	845,025	790,548
Inventories:		
Crude oil, petroleum products, chemicals and merchandise	403,520	385,440
Materials and supplies	107,475	112,453
Total Current Assets	2,491,589	1,615,157
Investments and Long-Term Receivables — (less allowances: 1978 — \$2,400; 1977 — \$7,714) — Note 2	229,902	501,072
Properties, Plants and Equipment, less accumulated depreciation, depletion and amortization — Note 4	4,046,400	3,560,847
Prepaid and Deferred Charges	167,468	159,427
	<u>\$6,935,359</u>	<u>\$5,836,503</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts and notes payable	\$ 796,590	\$ 673,869
Long-term debt and obligations due within one year — Notes 5, 6 and 7	85,937	80,133
Accrued taxes — Note 9	807,091	413,466
Other accruals	58,615	54,589
Total Current Liabilities	1,748,233	1,222,057
Long-Term Debt — Note 5	675,632	766,658
Other Long-Term Liabilities — Note 6	91,719	49,784
Accrued Contingent Liabilities — Note 8	143,903	94,120
Obligations Under Capital Leases — Note 7	120,830	156,303
Deferred Credits:		
Income taxes — Note 9	449,934	374,300
Other	58,768	76,157
Total Deferred Credits	508,702	450,457
Minority Interest in Consolidated Subsidiaries	10,395	10,325
Stockholders' Equity — Note 10:		
Common stock, \$1.25 par value:		
Shares authorized — 200,000,000		
Shares issued — (1978 — 154,449,429; 1977 — 153,717,809)	193,062	192,147
Capital in excess of par value of common stock	511,301	488,773
Earnings employed in the business	2,931,891	2,406,197
	3,636,254	3,087,117
Less treasury stock, at cost — (1978 — 22,716 shares; 1977 — 23,396 shares)	309	318
Total Stockholders' Equity	3,635,945	3,086,799
	<u>\$6,935,359</u>	<u>\$5,836,503</u>

PHILLIPS PETROLEUM COMPANY

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

	1978	1977
	(thousands of dollars)	
Funds Provided from Operations Consisted of —		
Net income	\$ 710,479	\$ 516,902
Sale of Pacific Petroleum Ltd.	(169,901)	—
Non-cash items included in earnings, as follows —		
Depreciation, depletion, amortization and retirements	460,461	336,702
Other	119,770	127,841
	<u>1,120,809</u>	<u>981,445</u>
While Funds Were Expended for —		
Properties, plants and equipment	956,172	1,091,438
Investments	18,734	36,273
Reduction of long-term borrowings	136,354	162,614
Dividends to Company stockholders	184,785	149,517
Other	43,190	68,336
Additions to (withdrawals from) working capital	350,256	(361,618)
	<u>1,689,491</u>	<u>1,146,560</u>
Which Left a Deficiency of	<u>\$ 568,682</u>	<u>\$ 165,115</u>
This Deficiency Was Financed by —		
Long-term borrowings	\$ 3,378	\$ 75,427
Property sales and retirements	50,553	53,412
Sale of Pacific Petroleum Ltd.	435,656	—
Sales of other investments	13,107	1,215
Proceeds from sale of Company stock	23,452	17,243
Long-term receivables and other	42,536	17,818
	<u>\$ 568,682</u>	<u>\$ 165,115</u>
Changes in Components of Working Capital:		
Cash and short-term investments	\$ 808,853	\$ (375,525)
Accounts and notes receivable	54,477	75,696
Inventories	13,102	52,181
Total Current Assets	<u>876,432</u>	<u>(247,648)</u>
Accounts and notes payable	122,721	114,456
Long-term debt and obligations due within one year	5,804	9,689
Accrued taxes and other accruals	397,651	(10,175)
Total Current Liabilities	<u>526,176</u>	<u>113,970</u>
Additions to (withdrawals from) working capital	<u>\$ 350,256</u>	<u>\$ (361,618)</u>

NOTES TO FINANCIAL STATEMENTS

NOTE 1 — ACCOUNTING POLICIES

Consolidation Principles and Investments — The consolidated statements include the accounts of companies owned more than 50%. Investments in companies owned 20% to 50%, inclusively, and in corporate joint ventures are accounted for using the equity method. Investments in other companies are carried at cost except that equity securities for which quoted prices are available are carried at the lower of aggregate cost or market, computed separately for current and noncurrent securities.

Inventories — Crude oil, petroleum products and chemicals are priced at cost, which is lower than market in the aggregate, mainly on the last-in, first-out basis. Materials and supplies are priced at average or replacement cost, with allowance for condition of used material.

Depreciation, Depletion and Amortization — Depreciation and amortization of properties, plants and equipment, including capital leases, are determined by the group straight-line method, individual unit straight-line method and the unit of production method, applying the method considered most appropriate for each type of property. Leasehold costs of producing properties and the intangible development cost of productive wells are depleted on the unit of production method based on estimated recoverable oil and gas reserves.

Exploratory Costs — Dry holes and undeveloped lease rentals are expensed. Geological and geophysical costs resulting in the acquisition or retention of leases are capitalized with the remainder being expensed. Undeveloped oil and gas leaseholds are capitalized and that portion of the costs applicable to properties which it is estimated will be surrendered is amortized over the estimated holding period.

Property Dispositions — When complete units of depreciable property are retired or sold, accumulated depreciation is reduced by the applicable amounts and any profit or loss is credited or charged to income. When less than complete units of depreciable property are disposed of or retired, the difference between asset cost and salvage value is charged or credited to accumulated depreciation.

Non-Mineral Leases — Capital lease obligations are stated primarily at fair value at inception and accounted for as properties, plants and equipment and as obligations under capital leases. The related amortization and the imputed interest expense are charged against income in lieu of lease rental expense.

Maintenance and Repairs — Maintenance and repairs are charged against income. Major renewals and replacements are charged to property accounts and the assets replaced are retired.

Dismantlement Costs — The estimated costs of dismantling certain facilities are accrued currently, using the unit of production method and the straight-line method, applying the method considered most appropriate for each type of property.

Foreign Currency Translation — In general, current assets (except inventories), current liabilities, long-term receivables and long-term debt are translated to U.S. dollars at currency exchange rates prevailing at balance sheet dates. Inventories, other assets and liabilities are translated at historical currency exchange rates. Revenues, costs and expenses are translated monthly using current exchange rates, except for costs related to balance sheet items which are translated at historical rates. Exchange gains and losses including gains and losses on forward exchange contracts are included in income in the period in which they occur.

Income Taxes — Deferred taxes are provided for all significant timing differences in the recognition of revenues and expenses for tax and financial purposes. The allowable investment tax credit is applied currently as a reduction of the provision for income taxes.

Net Income Per Share — Net income per share of common stock is calculated based upon the daily weighted average of the number of shares outstanding during the year.

Accounting by Oil and Gas Producing Companies — Financial Accounting Standards Board Statement No. 19 on “Financial Accounting and Reporting by Oil and Gas Producing Companies”, issued in December 1977, requires petroleum companies to use a prescribed form of “successful efforts” accounting effective for fiscal years beginning after December 15, 1978. While this implementation date was subsequently suspended, the Securities and Exchange Commission has designated such prescribed form of accounting as mandatory effective initially for full fiscal years ending after December 25, 1979 for companies electing to use “successful efforts” method of accounting. Phillips practices “successful efforts” accounting and it is believed reporting under the prescribed method would not have a material effect on 1978 or 1977 net income, nor would the cumulative effect of adopting such changes at January 1, 1977 have a material effect on earnings employed in the business.

NOTE 2 — INVESTMENTS AND LONG-TERM RECEIVABLES

Components of investments and long-term receivables at December 31, were as follows:

	1978	1977
	(thousands of dollars)	
Investments in and indebtedness of companies accounted for using the equity method	\$ 138,618	\$ 135,345
Pacific Petroleum Ltd. (at equity) ...	—	231,812
Other investments	45,527	55,326
Long-term receivables	48,157	86,303
	232,302	508,786
Less allowances	2,400	7,714
	<u>\$ 229,902</u>	<u>\$ 501,072</u>

NOTE 3 — SALE OF INTEREST IN PACIFIC PETROLEUMS LTD.

In November 1978, the Company sold its 10,326,321 shares of common stock of Pacific Petroleum Ltd. ("Pacific"), representing 48.2% of total shares outstanding, at a price of \$55.50 per share, which is equivalent to \$65.02 (Canadian) per share. As a result of the sale, net income increased \$169,901,000 (\$1.10 per share), after deducting income taxes of \$136,073,000. Equity in earnings of Pacific amounted to \$38,150,000 in 1978 and \$38,445,000 in 1977.

NOTE 4 — PROPERTIES, PLANTS AND EQUIPMENT

The Company's investment in properties, plants and equipment (at cost, except for capitalized leases) is summarized as follows:

	December 31	
	1978	1977
	(thousands of dollars)	
Natural Resources	\$4,193,336	\$3,751,290
Petroleum Products	1,339,651	1,241,582
Chemicals	1,062,201	949,357
Other	193,167	160,440
	6,788,355	6,102,669
Less accumulated depreciation, depletion and amortization	2,741,955	2,541,822
	<u>\$4,046,400</u>	<u>\$3,560,847</u>

The above schedule includes capitalized leases and related amortization of \$217,135,000 and \$108,761,000 for 1978 and \$260,730,000 and \$123,379,000 for 1977.

NOTE 5 — LONG-TERM DEBT

Long-term debt due after one year at December 31, 1978, consisted of the following, in thousands of dollars:

8 $\frac{7}{8}$ % Debentures Due 2000	\$250,000
7 $\frac{5}{8}$ % Debentures Due 2001	175,377
6% Guaranteed Sinking Fund Debentures Due 1981 ..	3,146
5 $\frac{5}{8}$ % Marine Terminal Revenue Bonds, Series 1977 Due 2007	20,000
Notes payable to banks, insurance companies and others:	
At 6.4% - 8%, due 1980-1983*	45,672
At 5 $\frac{1}{8}$ % - 6 $\frac{3}{8}$ %, due 1980-1991	152,859
At 4% - 5%, due 1980-1988	5,591
Purchase obligations	22,987
	<u>\$675,632</u>

*Includes \$21,743 in French francs, \$19,524 in British pounds and \$4,405 in other foreign currencies.

Maturities of long-term debt for the next five years are: 1979 — \$63,205,000 (included in current liabilities); 1980 — \$56,909,000; 1981 — \$50,035,000; 1982 — \$28,839,000; 1983 — \$20,258,000.

NOTE 6 — OTHER LONG-TERM LIABILITIES

Other long-term liabilities consist of accrued liabilities for dismantling certain exploration and production facilities, and miscellaneous liabilities.

NOTE 7 — NON-MINERAL LEASES

In 1977 the Company changed its method of accounting for non-mineral leases in accordance with Financial Accounting Standards Board Statement² No. 13 to retroactively apply the provisions of the Statement to January 1, 1973, the earliest practical data for recovering sufficient lease data. The 1973 financial statements have been restated to reflect this accounting change and, accordingly, net income for that year has been reduced \$18,170,000 (\$.12 per share) for the cumulative effect of the change to January 1, 1973. This change had no material effect on earnings for 1977 or any of the previous four years.

The Company leases bulk and service stations, railroad cars, tankers, oil and gas gathering systems, a natural gas liquefaction plant, chemical plants and other facilities and equipment. These leases involve both capital and operating leases, the major portion of which covers bulk and service stations and a natural gas liquefaction plant and related gathering system.

Most station leases have renewal options for varying periods at monthly rentals which equal or exceed the rentals paid during the primary lease term. Some station leases include purchase options exercisable after a specified number of years. Contingent rentals, where applicable, are generally based on the volume of motor fuel sold through the station. Many of the stations are subleased for the same amount of rentals and for the same term specified in the primary lease.

Capital lease data, in thousands of dollars, at December 31, 1978, follow:

Minimum lease payments:

1979	\$ 31,436
1980	28,621
1981	26,311
1982	22,701
1983	17,321
Remaining years	62,233
Total*	188,623
Less estimated executory costs	2,321
Net payments	186,302
Less imputed interest	43,659
Present value	142,643
Amount included in current liabilities	21,813
Obligations under capital leases	<u>\$120,830</u>

*Minimum payments have not been reduced by minimum sublease rentals of \$27,020 due under noncancelable subleases.

Minimum rental payments under operating leases having initial or remaining noncancelable lease terms in excess of one year as of December 31, 1978, in thousands of dollars, follow:

1979	\$ 25,178
1980	19,741
1981	14,136
1982	10,103
1983	8,305
Remaining years	43,440
Total*	<u>\$120,903</u>

*Minimum payments have not been reduced by minimum sublease rentals of \$13,414 due under noncancelable subleases.

Rentals for all operating leases for the years ended December 31, in thousands of dollars, follow:

	1978	1977
Minimum rentals	\$42,693	\$43,159
Contingent rentals	362	464
Total rentals	43,055	43,623
Less sublease rentals	17,590	17,990
Net rentals	<u>\$25,465</u>	<u>\$25,633</u>

NOTE 8 — LITIGATION AND CONTINGENT LIABILITIES

A number of legal proceedings are pending in various courts or agencies in which the Company or a subsidiary appears as plaintiff or defendant, including civil class action suits filed by the states of Florida, Connecticut, Kansas (subsequently dismissed on February 5, 1979), California, Arizona, Oregon and Washington (consolidated for pretrial procedures, including discovery and class certification, in the U. S. District Court at Los Angeles, California) against numerous petroleum companies, alleging extensive violations of the antitrust laws relating to the production and refining of crude oil, and the transportation and marketing of crude oil and refined products.

At December 31, 1978, the Company was contingently liable for \$211,964,000 of obligations principally of companies in which the Company has a minority interest. In addition, the Company has contingent liabilities with respect to claims and commitments arising from agreements with pipeline companies in which it or its subsidiaries hold stock interest whereby it may be required to provide such companies with additional funds through advances against future transportation charges.

While it is not possible at this time to establish the ultimate amount of liability in respect to contingent liabilities, the Company is of the opinion that the aggregate amount of any such liabilities for which provision has not been made will not have a materially adverse effect on its financial position.

NOTE 9 — TAXES

	1978	1977
	(thousands of dollars)	
Operating taxes		
Property	\$ 33,111	\$ 34,598
Gross production	40,918	35,052
Social security	27,461	23,330
Other	13,362	11,453
	<u>114,852</u>	<u>104,433</u>
Income taxes		
Federal		
Current	284,762	208,926
Deferred	48,245	38,384
Foreign		
Current	616,685	347,135
Deferred	26,668	57,032
State and local	26,151	18,263
	<u>1,002,511</u>	<u>669,740</u>
Total taxes charged to income	<u>1,117,363</u>	<u>774,173</u>
Excise taxes collected on the sale of petroleum products and paid to taxing agencies	176,000	183,000
	<u>\$1,293,363</u>	<u>\$ 957,173</u>

Deferred taxes on timing differences recognized in 1978 and 1977 were:

	1978	1977
	(thousands of dollars)	
Excess of tax over financial depreciation..	\$75,249	\$60,296
Excess of intangible drilling and certain other costs over financial provisions ...	25,055	32,301
Excess of financial over tax provision for dismantlement	(24,033)	(9,711)
Other	(637)	14,378
	<u>\$75,634</u>	<u>\$97,264</u>

A reconciliation between provision for income taxes and the amount of income tax determined by applying a 48% rate to income before income taxes (1978 — \$1,712,990,000; 1977 — \$1,186,642,000) follows:

	1978		1977	
	Amount in thousands of dollars	Percent of pretax income	Amount in thousands of dollars	Percent of pretax income
Federal statutory income tax	\$ 822,235	48.0%	\$569,588	48.0%
Foreign taxes in excess of 48% on U. S. companies operating in foreign countries	250,720	14.6	162,103	13.6
Investment tax credit	(50,369)	(2.9)	(49,951)	(4.2)
Other	(20,075)	(1.2)	(12,000)	(1.0)
	<u>\$1,002,511</u>	<u>58.5%</u>	<u>\$669,740</u>	<u>56.4%</u>

At December 31, 1978, the Company's equity in undistributed earnings of certain subsidiaries and corporate joint ventures (exclusive of amounts which if remitted in the near future would result in little or no tax because of available tax credits and other deductions) for which deferred taxes have not been provided because of reinvestment plans for such funds, approximated \$146,282,000.

The Internal Revenue Service has examined the Company's federal income tax returns through 1969 and all adjustments proposed have been settled. The Company is of the opinion that any adjustments made to the Company's returns for subsequent years will not have a material effect on the financial position of the Company.

NOTE 10 — STOCKHOLDERS' EQUITY

The authorized common stock of the Company was changed from 100,000,000 shares of \$2.50 par value each to 200,000,000 shares of \$1.25 par value each and a two-for-one stock split was effected as of the close of business May 7, 1977. All data relative to common stock and per share amounts in the financial statements and related notes have been adjusted accordingly.

During 1978 common stock issued increased 731,620 shares, treasury stock decreased 680 shares and capital in excess of par value of common stock increased \$22,528,000. This resulted from the sale of 585,600 shares to the Thrift Plan Trustee, the contribution of 146,020 shares to the Trust Fund established under the Employee Stock Ownership Plan and the distribution of treasury shares under the Incentive Compensation Plan.

NOTE 11 — RETIREMENT INCOME PLANS

The parent company and its subsidiaries have retirement plans covering substantially all of their employees. These plans are being funded based on pension costs accrued as determined by actuarial studies. Charges to income for such plans were \$52,115,000 for 1978 and \$46,135,000 for 1977. The increase resulted from greater participation and higher wages.

At January 1, 1978, the unfunded actuarial liability under the parent company's plan, which accounts for approximately 78% of total participants, amounted to approximately \$294,000,000, which is being amortized at the rate of 10% per year. At December 31, 1978, retirement plan assets of the parent company's plan exceeded the present value of vested benefits under such plan.

NOTE 12 — EMPLOYEE STOCK OWNERSHIP PLAN

In 1976, the Company adopted an Employee Stock Ownership Plan, effective January 1, 1975, for eligible employees of Phillips Petroleum Company and certain subsidiaries. The plan is funded solely by an additional one percent investment tax credit available for such purpose under the provisions of the Tax Reduction Act of 1975. The Act permits this one percent tax credit if an amount equal to the credit is used to provide company stock for employees; therefore, the plan had no effect on income. Under present provisions in the tax law the additional tax credit may be continued through 1983.

NOTE 13 — INCENTIVE COMPENSATION PLANS

Under the Company's Incentive Compensation Plan, adopted in 1965, and Long-Term Incentive Compensation Plan, adopted in 1978, provisions of \$5,008,000 and \$1,644,000, respectively, were made against 1978 earnings, in anticipation of awards to key employees under the two plans. These provisions were substantially less than the maximum permitted under the plans. A provision of \$4,857,000 was charged against 1977 earnings under the Incentive Compensation Plan.

NOTE 14 — RESEARCH AND DEVELOPMENT EXPENSES

Research and development costs charged to expense were \$58,246,000 in 1978 and \$48,461,000 in 1977.

NOTE 15 — FOREIGN CURRENCY TRANSLATION

Foreign currency translation gains and losses, other than those related to income tax accounts, are included as appropriate in equity in earnings of nonsubsidiary companies, costs and operating expenses and selling, general and administrative expenses. Income taxes applicable to such gains and losses and gains and losses arising from translation of income tax liabilities are included in the provision for income taxes. Exchange gains and losses, including translation gains and losses, net of tax effects, reduced earnings \$28,070,000 in 1978 compared to gains of 1977, which were not material.

NOTE 16 — SEGMENT AND GEOGRAPHIC INFORMATION

The Company is involved primarily in Petroleum and Chemicals operations. Petroleum operations are fully integrated and involve the discovery, production, transportation and refining of crude oil and natural gas together with the subsequent transportation and marketing of products derived therefrom. It also provides feedstock for the production of petrochemicals. Chemicals operations involve the manufacture and marketing of a broad range of petroleum-based chemicals products including synthetic rubber, carbon black, plastics, fertilizers, synthetic fibers and other products. The Other segment includes mainly coal, uranium and geothermal.

Segment and geographic information for 1978 and 1977 is presented on page 33. A reconciliation to the financial statements, in millions of dollars, follows:

	1978		1977	
	Operating profit	Identifiable assets	Operating profit	Identifiable assets
Operating profit	\$1,464		\$1,211	
Identifiable assets		\$5,470		\$4,907
Equity in earnings and assets of nonsubsidiary companies	41	139	40	367
Sale of Pacific Petroleum Ltd.	306			
Other revenues	65		87	
General corporate expenses, interest and income taxes ..	(1,166)		(821)	
Corporate assets		1,326		563
Net income	<u>\$ 710</u>		<u>\$ 517</u>	
Total assets		<u>\$6,935</u>		<u>\$5,837</u>
Return on average total assets	<u>11.6%</u>		<u>9.4%</u>	

Sales and other operating revenues by business segments and by geographic areas include both sales to customers outside the consolidated companies and sales within the consolidated companies which are generally at market value. In computing operating profit, none of the following items have been added or deducted: equity in earnings of nonsubsidiary companies, general corporate revenues and expenses, interest and income taxes. The Company's share of assets and earnings of nonsubsidiary companies, which are vertically integrated with operations of the Company, is not material.

Identifiable assets by business segments and geographic areas are those assets that are used in the Company's operations in each segment or area. Corporate assets are principally cash and short-term investments.

Intersegment and intergeographic sales and profits in inventory are eliminated in determining consolidated revenue and identifiable asset totals.

NOTE 17 — QUARTERLY FINANCIAL DATA (UNAUDITED)

	Sales and other operating revenues	Income before income taxes	Net income	Net income per share of common stock
	(millions of dollars except per share figures)			
1978				
First quarter	\$1,724	\$ 381	\$165	\$1.07
Second quarter	1,687	322	138	.90
Third quarter	1,727	323	108	.70
Fourth quarter	1,860	687	299*	1.94*
Total	<u>\$6,998</u>	<u>\$1,713</u>	<u>\$710*</u>	<u>\$4.61*</u>
1977				
First quarter	\$1,558	\$ 299	\$122	\$.79
Second quarter	1,551	280	125	.82
Third quarter	1,517	243	123	.80
Fourth quarter	1,658	365	147	.96
Total	<u>\$6,284</u>	<u>\$1,187</u>	<u>\$517</u>	<u>\$3.37</u>

*Includes net income from sale of Pacific Petroleum Ltd. stock of \$169,901,000 (\$1.10 per share).

NOTE 18 — ESTIMATED REPLACEMENT COSTS (UNAUDITED)

The Company's Annual Report on Form 10-K as filed with the Securities and Exchange Commission (a copy of which is available upon request) contains required information with respect to the estimated replacement cost of inventories and productive capacities at December 31, 1978 and 1977, and the related estimated effect of such costs on costs and operating expenses and depreciation, depletion and amortization.

TEN-YEAR FINANCIAL REVIEW (dollars in millions, except per share amounts)

	1978	1977	1976	1975	1974	1973	1972	1971	1970	1969
CONSOLIDATED BALANCE SHEETS AT DECEMBER 31										
Assets										
Current assets:										
Cash and short-term investments	\$1,135.6	\$ 326.7	\$ 702.3	\$ 522.7	\$ 393.5	\$ 441.1	\$ 338.5	\$ 225.1	\$ 137.1	\$ 187.4
Accounts and notes receivable — net	845.0	790.6	714.8	633.6	615.9	507.1	383.8	382.8	410.6	392.3
Inventories:										
Crude oil, petroleum products and chemicals ..	386.6	369.7	315.3	326.5	355.7	225.9	231.2	240.5	212.6	217.6
Merchandise	16.9	15.7	12.8	13.6	13.3	13.1	14.6	18.7	21.9	24.1
Materials and supplies	107.5	112.5	117.6	129.5	91.9	49.9	35.1	36.1	35.7	31.2
Total current assets	2,491.6	1,615.2	1,862.8	1,625.9	1,470.3	1,237.1	1,003.2	903.2	817.9	852.6
Investments and long-term receivables — net	229.9	501.1	460.1	437.5	399.3	423.7	377.8	391.8	361.6	383.5
Properties, plants and equipment — net	4,046.4	3,560.8	2,822.1	2,601.7	2,329.7	2,143.6	1,857.8	1,838.0	1,850.5	1,846.4
Prepaid and deferred charges	167.5	159.4	102.6	82.4	50.3	44.0	30.8	33.7	41.5	39.9
Total assets	6,935.4	5,836.5	5,247.6	4,747.5	4,249.6	3,848.4	3,269.6	3,166.7	3,071.5	3,122.4
Liabilities and stockholders' equity										
Current liabilities:										
Accounts and notes payable	\$796.6	\$ 673.9	\$ 559.4	\$ 526.3	\$ 542.9	\$ 400.7	\$ 276.5	\$ 254.5	\$ 280.3	\$ 251.1
Long-term debt and obligations due										
within one year	85.9	80.1	70.4	73.1	61.7	82.5	52.7	52.2	106.1	75.9
Accrued taxes	807.1	413.5	428.8	261.9	264.9	117.7	113.1	102.5	114.5	119.7
Other accruals	58.6	54.6	49.5	48.3	43.2	42.8	40.6	36.1	28.9	27.9
Total current liabilities	1,748.2	1,222.1	1,108.1	909.6	912.7	643.7	482.9	445.3	529.8	474.6
Long-term debt	675.6	766.7	839.0	892.7	658.2	799.1	791.8	800.2	687.9	787.4
Other long-term liabilities	91.7	49.8	—	—	—	—	—	—	—	—
Accrued contingent liabilities	143.9	94.1	60.3	66.4	60.0	90.4	67.0	60.7	57.4	50.5
Obligations under capital leases	120.8	156.3	175.8	199.6	221.1	242.4	—	—	—	—
Deferred income taxes	450.0	374.3	277.0	185.7	57.0	48.3	61.5	63.0	57.3	59.7
Other deferred credits	58.8	76.1	74.7	75.4	77.1	73.7	41.9	41.8	36.3	51.7
Minority interest in consolidated subsidiaries	10.4	10.3	10.5	12.0	8.0	5.4	4.7	6.5	9.9	21.1
Stockholders' equity:										
Common stock, \$1.25 par value	193.1	192.1	191.4	190.7	190.7	190.7	190.6	190.5	190.3	190.3
Capital in excess of par value of common stock ..	511.3	488.8	472.3	455.1	451.3	444.0	440.8	437.2	433.3	433.3
Earnings employed in the business	2,931.9	2,406.2	2,038.8	1,760.8	1,617.8	1,325.7	1,211.7	1,160.9	1,125.4	1,110.4
	3,636.3	3,087.1	2,702.5	2,406.6	2,259.8	1,960.4	1,843.1	1,788.6	1,749.0	1,734.0
Less treasury stock	.3	.3	.3	.5	4.3	15.0	23.3	39.4	56.1	56.6
Total stockholders' equity	3,636.0	3,086.8	2,702.2	2,406.1	2,255.5	1,945.4	1,819.8	1,749.2	1,692.9	1,677.4
Total liabilities and stockholders' equity	6,935.4	5,836.5	5,247.6	4,747.5	4,249.6	3,848.4	3,269.6	3,166.7	3,071.5	3,122.4
Stockholders' equity per share*	\$23.54	\$ 20.08	\$ 17.65	\$ 15.78	\$ 14.82	\$ 12.85	\$ 12.07	\$ 11.70	\$ 11.43	\$ 11.33

PROPERTIES, PLANTS AND EQUIPMENT

Gross investment

Natural resources	\$4,193.3	\$3,751.3	\$3,066.4	\$2,700.5	\$2,544.9	\$2,182.6	\$1,909.9	\$1,803.3	\$1,756.4	\$1,736.5
Petroleum products	1,339.7	1,241.6	1,231.2	1,431.6	1,333.2	1,289.2	1,142.0	1,144.1	1,152.2	1,132.2
Chemicals	1,062.2	949.4	800.0	742.3	706.7	841.3	763.8	733.5	684.1	630.0
Other	193.2	160.4	142.4	117.8	110.6	105.2	98.4	98.6	100.1	97.4
	6,788.4	6,102.7	5,240.0	4,992.2	4,695.4	4,418.3	3,914.1	3,779.5	3,692.8	3,596.1

Net investment

Natural resources	\$2,577.6	\$2,298.0	\$1,720.1	\$1,452.4	\$1,265.2	\$1,000.9	\$ 818.2	\$ 758.9	\$ 745.6	\$ 748.3
Petroleum products	748.3	633.7	634.6	725.9	658.5	642.3	558.6	592.3	634.7	654.8
Chemicals	605.1	538.2	390.7	370.2	355.6	451.8	433.1	436.1	416.4	389.2
Other	115.4	90.9	76.7	53.2	50.4	48.6	47.9	50.7	53.8	54.1
	4,046.4	3,560.8	2,822.1	2,601.7	2,329.7	2,143.6	1,857.8	1,838.0	1,850.5	1,846.4

*Adjusted for two-for-one stock splits in 1977 and 1969.

Note — Financial data for 1976, 1975, 1974 and 1973 have been restated to reflect adoption of capitalization of leases (see Note 7 of notes to financial statements).

	1978	1977	1976	1975	1974	1973	1972	1971	1970	1969
CONSOLIDATED STATEMENTS OF INCOME										
Sales and other operating revenues:										
Natural resources	\$1,349.2	\$ 904.1	\$ 816.9	\$ 752.9	\$ 622.7	\$ 428.7	\$ 386.8	\$ 368.2	\$ 365.3	\$ 360.9
Petroleum products	4,252.1	4,103.1	3,634.6	3,307.4	3,015.7	1,661.1	1,478.9	1,443.3	1,412.6	1,350.6
Chemicals	1,384.0	1,273.6	1,229.6	1,057.4	1,319.6	881.7	630.1	537.3	481.9	476.1
Other	12.5	3.4	16.4	15.9	22.7	18.5	16.9	14.4	13.3	14.4
Total sales and other operating revenues	6,997.8	6,284.2	5,697.5	5,133.6	4,980.7	2,990.0	2,512.7	2,363.2	2,273.1	2,202.0
Sale of Pacific Petroleum Ltd.	306.0	—	—	—	—	—	—	—	—	—
Other revenues (including equity in earnings of nonsubsidiary companies)	119.3	121.6	139.4	79.3	125.0	83.5	54.8	49.1	38.2	30.0
Total revenues	7,423.1	6,405.8	5,836.9	5,212.9	5,105.7	3,073.5	2,567.5	2,412.3	2,311.3	2,232.0
Costs and operating expenses	4,772.0	4,404.3	4,017.9	3,668.8	3,597.2	2,088.0	1,711.0	1,615.3	1,541.2	1,486.7
Selling, general and administrative expenses	284.1	291.8	322.2	322.5	311.6	290.5	298.1	288.3	288.0	270.5
Depreciation, depletion, amortization and retirements	460.5	336.7	304.0	326.0	273.6	238.9	223.1	201.3	198.4	195.1
Taxes other than income taxes	114.8	104.4	93.0	93.8	84.8	69.0	63.9	59.7	57.6	53.8
Interest and expense on indebtedness	78.7	82.0	68.3	49.8	52.8	62.3	58.8	62.6	54.2	49.6
Provision for income taxes	1,002.5	669.7	619.8	409.4	356.0	94.4	64.2	52.8	52.0	46.2
Total costs and expenses	6,712.6	5,888.9	5,425.2	4,870.3	4,676.0	2,843.1	2,419.1	2,280.0	2,191.4	2,101.9
Income before extraordinary items and accounting change	710.5	516.9	411.7	342.6	429.7	230.4	148.4	132.3	119.9	130.1
Extraordinary items and accounting change	—	—	—	—	(27.6)	(18.2)	—	—	(8.7)	—
Net income	710.5	516.9	411.7	342.6	402.1	212.2	148.4	132.3	111.2	130.1
Per average share outstanding:*										
Income before extraordinary items and accounting change	\$4.61	\$3.37	\$2.69	\$2.25	\$2.83	\$1.52	\$.99	\$.89	\$.81	\$.88
Net income	\$4.61	\$3.37	\$2.69	\$2.25	\$2.65	\$1.40	\$.99	\$.89	\$.75	\$.88
Dividends per share*	\$1.20	\$.97½	\$.87½	\$.80	\$.72½	\$.65	\$.65	\$.65	\$.65	\$.65
Income before extraordinary items and accounting change:										
As percent of average total assets	11.6	9.4	8.3	7.9	10.6	6.4	4.6	4.3	3.9	4.4
As percent of total revenues	9.6	8.1	7.1	6.6	8.4	7.5	5.8	5.5	5.2	5.8
Percent of total revenues from outside U. S.	29.5	21.1	22.5	18.6	24.5	21.5	16.1	17.4	13.4	12.2

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

Source										
Funds from operations	\$1,120.8	\$ 981.4	\$ 814.7	\$ 723.9	\$ 758.4	\$ 469.3	\$ 367.4	\$ 332.7	\$ 316.6	\$ 317.4
Long-term debt	3.4	75.4	66.8	325.4	85.4	86.3	49.7	257.0	10.0	210.9
Property sales and retirements (including extraordinary items)	50.6	53.4	199.5	99.3	106.9	43.2	28.6	43.7	31.1	27.1
Sales of investments (including extraordinary items)	448.8	1.2	24.0	3.7	20.5	9.6	26.2	14.3	23.1	5.3
Capital stock	23.4	17.3	18.0	7.6	18.0	11.6	19.8	20.8	.5	6.8
Other	42.5	17.9	—	1.5	14.7	19.1	4.0	6.5	2.8	17.4
	<u>1,689.5</u>	<u>1,146.6</u>	<u>1,123.0</u>	<u>1,161.4</u>	<u>1,003.9</u>	<u>639.1</u>	<u>495.7</u>	<u>675.0</u>	<u>384.1</u>	<u>584.9</u>
Application										
Properties, plants and equipment:										
Natural resources	\$605.0	\$ 805.9	\$ 482.7	\$ 490.6	\$ 450.7	\$ 245.0	\$ 196.0	\$ 143.3	\$ 132.3	\$ 207.3
Petroleum products	191.2	83.6	110.4	139.9	92.3	45.7	28.0	26.9	39.6	35.1
Chemicals	125.7	161.0	121.3	56.9	68.3	35.9	38.7	51.6	62.5	71.4
Other	34.3	40.9	13.4	6.5	6.7	2.4	2.0	3.2	5.0	2.8
Total	956.2	1,091.4	727.8	693.9	618.0	329.0	264.7	225.0	239.4	316.6
Investments	18.7	36.3	36.6	35.3	9.5	22.7	6.2	23.2	7.2	66.1
Reduction in long-term debt	136.3	162.6	149.4	112.4	254.9	101.6	58.1	144.7	109.5	78.8
Cash dividends	184.8	149.5	133.7	121.8	110.0	98.2	97.6	96.8	96.3	96.2
Other	43.2	68.4	37.0	39.3	47.3	(3.9)	6.7	15.6	21.6	15.4
Increase (decrease) in working capital	350.3	(361.6)	38.5	158.7	(35.8)	91.5	62.4	169.7	(89.9)	11.8
	<u>1,689.5</u>	<u>1,146.6</u>	<u>1,123.0</u>	<u>1,161.4</u>	<u>1,003.9</u>	<u>639.1</u>	<u>495.7</u>	<u>675.0</u>	<u>384.1</u>	<u>584.9</u>

*Adjusted for two-for-one stock splits in 1977 and 1969.

Note — Financial data for 1976, 1975, 1974 and 1973 have been restated to reflect adoption of capitalization of leases (see Note 7 of notes to financial statements).

	1978	1977	1976	1975	1974	1973	1972	1971	1970	1969
CHEMICALS										
OPERATING REVENUES										
Basic petrochemicals and specialty chemicals	\$ 478.5	\$ 420.4	\$ 417.5	\$ 318.9	\$ 423.6	\$ 166.3	\$ 119.2	\$ 108.2	\$ 102.4	\$ 102.0
Rubber chemicals	253.6	222.4	190.1	164.4	173.2	111.2	93.0	81.2	70.5	68.0
Plastic resins	242.7	219.9	208.9	130.3	131.0	94.9	62.4	51.5	51.2	50.0
Consumer products	194.6	173.8	159.6	151.9	138.5	110.0	100.0	86.6	94.0	95.3
Fertilizers	62.8	76.7	77.8	114.3	160.0	158.0	100.5	91.6	72.0	69.1
Synthetic fibers	72.7	75.5	70.8	92.2	161.4	151.1	103.2	70.2	57.6	59.3
Other sales and services	79.1	84.9	104.9	85.4	131.9	90.2	51.8	48.0	34.2	32.4
	<u>1,384.0</u>	<u>1,273.6</u>	<u>1,229.6</u>	<u>1,057.4</u>	<u>1,319.6</u>	<u>881.7</u>	<u>630.1</u>	<u>537.3</u>	<u>481.9</u>	<u>476.1</u>

OTHER DATA

Shares outstanding at year-end — thousands*	154,427	153,694	153,110	152,487	152,204	151,419	150,773	149,481	148,124	148,082
Number of stockholders at year-end	122,624	122,296	120,170	126,865	131,621	135,966	153,292	166,012	172,979	157,052
Total payroll including employee benefits	\$ 720.5	\$ 613.2	\$ 550.2	\$ 528.8	\$ 478.9	\$ 415.1	\$ 387.3	\$ 352.8	\$ 335.0	\$ 326.8
Number of employees at year-end	30,008	28,353	27,797	30,506	30,802	33,429	35,265	33,280	32,208	32,660

*Adjusted for two-for-one stock splits in 1977 and 1969.

TEN-YEAR OPERATING REVIEW

NATURAL RESOURCES

NET PRODUCTION OF LIQUID RAW MATERIALS — thousands of barrels daily

Crude Oil										
United States										
Texas	45.5	48.4	50.8	54.2	56.3	57.7	57.7	54.9	54.6	51.8
Alaska	24.2	9.9	4.6	4.2	4.1	4.7	4.5	5.5	5.6	6.9
Louisiana	15.7	17.4	18.4	18.0	19.6	21.5	23.3	24.8	29.6	28.1
Oklahoma	9.8	10.1	10.5	10.4	11.8	13.7	17.5	15.6	15.5	16.2
New Mexico	5.6	6.2	6.8	6.9	7.4	8.0	9.0	9.8	10.4	10.3
Arkansas	4.5	4.7	4.1	4.1	3.1	2.4	2.7	2.6	2.7	2.7
Wyoming	4.1	4.7	4.6	4.2	4.5	2.0	2.7	3.7	6.3	6.2
Other states	15.6	15.6	15.5	16.4	16.7	12.3	12.8	13.2	14.2	15.4
	<u>125.0</u>	<u>117.0</u>	<u>115.3</u>	<u>118.4</u>	<u>123.5</u>	<u>122.3</u>	<u>130.2</u>	<u>130.1</u>	<u>138.9</u>	<u>137.6</u>
Outside United States										
Europe	116.8	93.1	92.8	63.1	11.5	10.7	11.0	2.3	—	—
Africa	44.9	43.6	38.6	33.8	38.1	35.5	23.2	25.5	20.0	40.0
Southeast Asia	18.3	5.6	—	—	—	—	—	—	—	—
Middle East	5.4	5.6	5.9	6.2	9.1	9.1	12.6	14.0	12.2	2.6
Latin America	—	—	—	15.5	20.8	23.1	19.5	19.5	20.6	21.4
	<u>185.4</u>	<u>147.9</u>	<u>137.3</u>	<u>118.6</u>	<u>79.5</u>	<u>78.4</u>	<u>66.3</u>	<u>61.3</u>	<u>52.8</u>	<u>64.0</u>
Total crude oil	<u>310.4</u>	<u>264.9</u>	<u>252.6</u>	<u>237.0</u>	<u>203.0</u>	<u>200.7</u>	<u>196.5</u>	<u>191.4</u>	<u>191.7</u>	<u>201.6</u>
Natural Gas Liquids										
United States	133.8	138.2	130.8	125.9	132.2	134.8	137.5	135.4	131.8	130.3
Europe	.2	.2	.3	.3	.3	.3	.3	.2	.2	—
Latin America	—	—	—	1.8	2.3	2.3	2.4	2.6	2.2	1.1
Total natural gas liquids	<u>134.0</u>	<u>138.4</u>	<u>131.1</u>	<u>128.0</u>	<u>134.8</u>	<u>137.4</u>	<u>140.2</u>	<u>138.2</u>	<u>134.2</u>	<u>131.4</u>
Total all liquids	<u>444.4</u>	<u>403.3</u>	<u>383.7</u>	<u>365.0</u>	<u>337.8</u>	<u>338.1</u>	<u>336.7</u>	<u>329.6</u>	<u>325.9</u>	<u>333.0</u>

	1978	1977	1976	1975	1974	1973	1972	1971	1970	1969
NET NATURAL GAS PRODUCTION —										
millions of cubic feet daily										
United States	1,130	1,159	1,247	1,312	1,433	1,481	1,534	1,566	1,591	1,436
Europe	419	184	133	125	116	94	85	58	40	14
Latin America	—	—	—	18	21	28	34	41	48	33
	1,549	1,343	1,380	1,455	1,570	1,603	1,653	1,665	1,679	1,483
WELL COMPLETIONS — Net										
United States — Exploratory	6	5	18	44	53	38	37	21	25	24
— Development	94	134	161	172	136	156	86	70	67	118
Outside United States — Exploratory	20	14	13	21	24	23	19	20	20	17
— Development	3	6	8	12	16	9	4	18	4	9
	123	159	200	249	229	226	146	129	116	168
OIL AND GAS WELLS — Net										
United States — Oil	6,141	6,210	6,202	6,191	6,184	5,806	5,795	6,004	6,316	6,457
— Gas and condensate	2,164	2,132	2,129	2,122	2,086	2,006	1,945	1,936	1,964	1,997
Outside United States — All wells	79	105	91	82	267	262	249	310	312	387
	8,384	8,447	8,422	8,395	8,537	8,074	7,989	8,250	8,592	8,841
NET OIL AND GAS ACREAGE — thousands of acres										
United States	6,090	5,965	6,570	7,197	7,203	6,792	5,793	5,382	5,273	4,709
Canada	2,627	2,130	3,174	3,452	3,511	3,166	2,820	2,246	2,174	1,867
Latin America	20,285	4,679	3,624	12,228	13,012	5,829	3,310	695	3,185	4,742
Europe	1,387	1,002	1,457	1,457	1,511	1,397	1,267	1,227	1,424	1,394
Africa	15,244	6,895	7,185	7,994	13,158	9,906	13,816	8,403	9,009	13,860
Middle East	19	20	1,753	1,753	3,031	3,031	2,893	13,852	13,852	12,252
Southeast Asia	5,274	10,139	24,960	28,564	32,086	37,348	31,018	38,852	47,106	57,627
New Zealand and Australia	22,527	23,829	23,678	1,511	5,335	6,072	5,969	6,272	7,290	9,290
	73,453	54,659	72,401	64,156	78,847	73,541	66,886	76,929	89,313	105,741
PETROLEUM PRODUCTS										
REFINERY RUNS — thousands of barrels daily										
United States — Crude oil	302	297	318	368	373	395	386	371	364	359
— Natural gas liquids	138	153	142	133	148	147	156	155	160	155
Outside United States — Crude oil	—	—	—	2	1	2	3	8	15	15
	440	450	460	503	522	544	545	534	539	529
REFINERY CAPACITY — thousands of barrels daily										
United States — Crude oil	323	323	323	408	408	404	404	399	398	390
— Natural gas liquids	186	186	186	165	165	165	165	165	165	165
Outside United States — Crude oil	—	—	—	—	6	4	4	24	24	24
	509	509	509	573	579	573	573	588	587	579
PETROLEUM PRODUCTS SOLD — thousands of barrels daily										
United States										
Automotive gasoline	250	237	272	304	286	299	323	311	314	294
Aviation fuels	27	26	25	24	30	27	27	27	35	38
Distillates	82	72	87	99	100	95	101	98	106	109
Liquefied petroleum gas	92	119	101	97	92	91	111	106	114	107
Other products	32	37	43	31	33	41	43	41	47	48
	483	491	528	555	541	553	605	583	616	596
Outside United States	33	41	49	56	60	84	72	88	64	36
Total	516	532	577	611	601	637	677	671	680	632
MARKETING OUTLETS	13,638	14,773	15,628	17,722	18,574	21,225	23,678	24,359	25,354	25,744

PRODUCTS

Automotive gasolines

Diesel fuel

Aviation fuels — gasolines, commercial and military jet fuels, anti-icing additive

Stove oil No. 1 (Range oil)

Furnace oil No. 2

Residual fuel oils

Liquefied petroleum gases — motor fuel (propane, butane, butane-propane mixtures), commercial propane, butane, butane-propane mixtures, normal and isobutane, ethane

Kerosene

Crude oil

Natural gas

Liquefied natural gas

Lubricants — automotive, industrial, farm and ranch, marine and fleet lubricants; aviation and snowmobile oils

Tire and tubes — passenger car, truck, trailer, farm

Batteries — automobile, truck and bus, farm, marine, small vehicles

Automotive accessories — anti-freeze, auto lamps, spark plugs, wiper blades, filters, belts, automotive chemicals

Fertilizers:

Anhydrous ammonia

Aqua ammonia

Ammonium nitrate

Urea-ammonium nitrate solution

Nitrate solution

Mixed liquid fertilizer solutions

Blasting materials — industrial ammonium nitrate

Asphalt and asphalt emulsions

Road oils

Wax

Helium — high-purity gas and liquid, and cryogenic hardware

Rubber chemicals:

Butadiene and Butene - 1

Carbon black

Synthetic elastomers and plastomers

Extender oils

Plastomer compounds

Plastic resins:

Polyethylenes

Polypropylenes

Polyphenylene sulfide

Butadiene-styrene copolymers

Rigid packaging — paperboard and plastic containers for consumer and industrial products

Rigid packaging machinery

Polypropylene packaging material — decorative and functional

Plastic tubular goods — plastic pipe and fittings, conduit and duct, corrugated conduit

Custom fabricated plastic products — for the automotive, appliance, radio and TV industries

Other plastic products:

Horticulture ware

Bakery handling equipment

Fifth wheel liner

Guy wire guard

Poultry and egg handling equipment

Coating or laminating plastics and other materials — to paper, foil and other substrates for the paper, packaging automotive, food, locker and specialty fields

Release paper and film

Special chemicals:

Aliphatic solvents such as pentanes, hexanes, heptanes

Benzene

Binder for solid rocket fuels

Calcium petroleum sulfonates

Carburetor detergent

Cyclohexane

Ethylene

High-purity hydrocarbons for research and development (available in several grades of purity) — aromatics, cycloolefins, cycloparaffins, diolefins, olefins, paraffins, alkylaromatics

Hydrocarbon aerosol propellants

Hydroxyethylcellulose

Mercaptans

Methylvinylpyridine

Mixed xylenes

Odorless solvents

Orthoxylene

Paraffinic naphtha

Paraxylene

Polyacrylamides

Sulfur chemicals

Odorants for natural gas and LP-gas

Mercaptan intermediates (for agricultural chemicals and other uses) such as ethyl, n-propyl, n-butyl and n-dodecyl mercaptans, tertiary mercaptans and ethylthioethanol

Sulfolane and sulfolene

2-Mercaptoethanol

Polymerization solvents

Propylene

Reference fuels

Sealant polymer

Special fuels

Sulfur

Sulfuric acid

Toluene

Viscosity index improver

Tubing and metal products:

Stainless steel and nickel alloy tubing for aerospace and other industries

Custom fabricated parts for automotive, refrigeration and other industries

Patio and porch furniture

Man-made fibers:

Olefin yarn and staple

Formed fabrics

Construction materials:

Civil engineering fabric

Drilling mud and cement additives

SERVICES

Laboratory evaluations of petroleum reservoirs and process designs for enhanced oil recovery

Process evaluation service and analysis and computer control systems for petroleum, petrochemical and chemical industries

Radio frequency geophysical data collection systems

Tanker hauling

Terminaling services

LPG importing services

Metallurgical consulting services

Liquefied natural gas technological services

Pipeline transportation

Project management, engineering design and process engineering services

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^{*}Member Executive Committee

^{**}Member Audit Committee

[†]Member Compensation Committee

[‡]Member Nominating Committee

Listed as of March 1, 1979.

OFFICES

PRINCIPAL OFFICES

Bartlesville, Oklahoma 74004
80 Broadway, New York, New York 10005
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STOCK TRANSFER OFFICES

Phillips Petroleum Company
80 Broadway
New York, New York 10005

Phillips Petroleum Company
15 Exchange Place
Jersey City, New Jersey 07302

Montreal Trust Company
15 King Street West
Toronto, Ontario, Canada M5H 1B4

REGISTRARS

Manufacturers Hanover Trust Company
40 Wall Street
New York, New York 10005

Canada Permanent Trust Company
20 Eglinton Avenue West
Toronto, Ontario, Canada M4R 2E2

PRINCIPAL SUBSIDIARIES AND AFFILIATES

APPLIED AUTOMATION, INC.

PHILLIPS COAL COMPANY

PHILLIPS FIBERS CORPORATION

N.V. PHILLIPS PETROLEUM CHEMICALS S.A.

PHILLIPS PETROLEUM COMPANY EUROPE-AFRICA

PHILLIPS PIPE LINE COMPANY

PHILLIPS PUERTO RICO CORE INC.

PHILLIPS URANIUM CORPORATION

PHILTANKERS INC.

PIER 66 COMPANY

SEALRIGHT CO., INC.

PHILLIPS CHEMICAL COMPANY,
A DIVISION OF PHILLIPS PETROLEUM COMPANY

"Phillips," "the Company," "we" and "our" are used interchangeably in this report to refer to the business of Phillips Petroleum Company and its consolidated subsidiaries. Where reference is made to a particular company, it is wholly owned unless otherwise stated. The Company's consolidation policy is to include in financial statements the accounts of companies in which more than 50% interest is held.

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Wm. C. Douce, President and Chief Operating Officer

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C. J. Silas, Senior Vice President

Edwin Van den Bark, Senior Vice President Exploration and Production

L. M. Rickards, Vice President North America Exploration and Production

Paul W. Tucker, Vice President Gas and Gas Liquids

W. W. Dunn, Managing Director Latin America-Asia Exploration and Production

Earl Guitar, Managing Director Europe-Africa Exploration and Production (London)

W. R. Bohon, Manager Energy Minerals

R. H. Jukes, Manager Worldwide Production

C. D. Davidson, Manager International Affairs and Administration

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W. T. Kuepker, Manager Accounting

A. R. Rehrig, Manager Operations Analysis and Control

O. D. Thomas, Manager Worldwide Exploration

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G. J. Morrison, Vice President Marketing

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D. B. Taylor, Manager Transportation

J. E. Arnold, Manager Planning and Budgeting

B. L. Danley, Manager Accounting

J. R. Hudkins, Manager Administration

T. D. Lockin, Manager Operations Analysis and Control

T. C. Morris, Controller

CHEMICALS GROUP

L. H. Johnstone, Executive Vice President

R. G. Askew, Senior Vice President

A. J. Head, President, Phillips Fibers Corporation (Greenville, South Carolina)

R. G. Rhodes, Vice President Planning and Development

E. H. McNeil, Manager Fertilizer

J. N. Scott, Manager Plastics (Houston)

H. T. Sears, Jr., Manager Rubber Chemicals

W. K. Shriver, Manager Consumer Products (Houston)

K. L. Smalley, Manager Petrochemicals

J. J. Kavanagh, Manager Europe-Africa (Brussels)

Frank Rendon, Manager Latin America (Houston)

C. M. Wilson, Manager Asia (Hong Kong)

R. M. Dixon, Manager Administration

W. H. Guthrie, Manager Business Promotion

H. F. Thill, Controller

OTHER CORPORATE OFFICERS

R. G. Wallace, Senior Vice President

LeRoy Culbertson, Senior Vice President Planning and Budgeting

O. W. Armstrong, Vice President Treasury

Sloan K. Childers, Vice President Public Affairs

Glenn A. Cox, Vice President Management Information and Control

J. W. Davison, Vice President Research and Development

A. J. Head, Vice President Fibers

Kenneth Heady, Vice President and General Counsel

Russell L. Howard, Vice President New York Office

Carstens Slack, Vice President Washington Office

W. R. Thomas, Vice President Human Resources

C. H. Trotter, Vice President Corporate Management Services

H. D. Trotter, Vice President Engineering and Services

R. E. Bonnell, Treasurer

Joseph W. O'Toole, General Tax Officer

Richard E. Roberson, Jr., Comptroller

Harvey W. Thompson, Secretary

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R. Y. Bandy, Jr., Associate General Counsel

S. E. Floren, Associate General Counsel

C. J. Roberts, Associate General Counsel

J. Bryan Whitworth, Associate General Counsel

M. L. Collins, Manager Real Estate and Insurance

R. S. Dickson, Manager Information Services

D. R. Hynes, Manager Purchasing

W. J. Kramer, Manager Aviation

H. D. Powell, Manager Operations Analysis and Control

J. F. Sauls, Manager General Services

MANAGEMENT CHANGES

Robert N. Sears, a member of the board and senior vice president New York office, retired effective February 1, 1979. Sears, who had 40 years of service, was succeeded by Russell L. Howard, who was elected vice president New York office. Howard had been manager of the New York office.

In 1978 Phillips elected five other new corporate officers. Richard G. Askew, C. J. Silas and R. G. Wallace were elected senior vice presidents. In addition,

A. J. Head was elected vice president fibers and Paul W. Tucker was elected vice president gas and gas liquids.

Askew was formerly vice president petrochemicals, Silas was formerly vice president gas and gas liquids, and Wallace was formerly vice president plastics. Tucker was formerly manager of international gas and gas liquids. Head remains president of Phillips Fibers Corporation.

PHILLIPS PETROLEUM COMPANY
BARTLESVILLE, OKLAHOMA 74004

